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INDEX AND SUMMARY OF H. R. 10650

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Apr. 20, 1961 Both Houses received President's tax message.

Mar. 12, 1961 Rep. Mills introduced H. R. 10650 which was referred to the Ways and Means Committee.

LEGISLATIVE HISTORY

Mar. 15, 1962 Public Law 87-834
H. R. 10650 of interest to this Department.

Mar. 16, 1962 House committee reported H. R. 10650 without amendment. H. Report No. 1247. Print of bill and report.

Mar. 22, 1962 House Rules Committee reported resolution for consideration of H. R. 10650. H. Res. 575. H. Report No. 1283. Print of resolution and report.

Mar. 28, 1962 House began debate on H. R. 10650.

Mar. 29, 1962 House passed H. R. 10650 with amendments.

Apr. 2, 1962 H. R. 10650 was referred to the Senate Finance Committee. Print of bill as referred.

July 12, 1962 Sen. Kerr submitted a proposed amendment.

July 20, 1962 Sen. Byrd inserted an announcement of the Senate Finance Committee of action taken by the committee on H. R. 10650.

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Aug. 16, 1962 Senate committee reported H. R. 10650 with amendments. S. Report No. 1261. Print of bill and report.

Aug. 23, 1962 Summary of H. R. 10650 as reported by Senate committee.

Aug. 24 and 25, 1962 Several Senators submitted proposed amendments to H. R. 10650.

H. R. 10650 was made unfinished business.

Senate began debate.

Aug. 27, 1962 Senate continued debate on H. R. 10650.

Aug. 28, 1962 Senate continued debate.

Aug. 29, 1962 Senate continued debate.

Aug. 30, 1962 Senate continued debate.

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Apr. 20, 1961 Both Houses received President's tax message.

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Mar. 15, 1962 Summary of items of interest to this Department.

Mar. 16, 1962 House committee reported H. R. 10650 without amendment. H. Report No. 1447. Print of bill and report.

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July 31, 1962 Senate committee voted to report (but did not actually report) H. R. 10650.

Aug. 16, 1962 Senate committee reported H. R. 10650 with amendments. S. Report No. 1881. Print of bill and report.

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Aug. 30, 1962 Senate continued debate.

Aug. 31, 1962 Senate continued debate.

Sept. 4, 1962 Senate continued debate.
Sept. 5, 1962 Senate continued debate.
Sept. 6, 1962 Senate passed H. R. 10650 with amendments.
Senate conferees were appointed.
Sept. 10, 1962 House conferees were appointed.
Sept. 25, 1962 Conferees agreed to file a report.
Oct. 1, 1962 House received conference report on H. R. 10650.
H. Report No. 2508. Print of report.
Oct. 2, 1962 Both Houses agreed to the conference report.
Oct. , 1962 Approved: Public Law 87- .

HEARINGS: Senate Finance Committee on H. R. 10650: Parts
1 - 12.

House Ways and Means Committee, Miscellaneous
hearing - "President's Tax Recommendations"
Parts 1 - 4.

DIGEST OF PUBLIC LAW 87-834

REVENUE ACT OF 1962. Makes various revisions in the Federal tax system. Provides that cooperatives are to receive a deduction for patronage dividends paid to the patrons in cash or by allocations if the patron has the option to redeem the allocations in cash during a 90-day period after issuance, or consents to treating this income as constructively received and reinvested in the cooperative. The patron may give his consent individually in writing, the cooperative may by its bylaws require members to give this consent, or patrons may give their consent by endorsing a check representing at least 20 percent of the total patronage dividend. At least 20 percent of the patronage dividend must be paid in cash for any allocation to be deductible to the cooperative. Any of the amounts which are deductible to the cooperative must be included in the income of the patron for tax purposes when received if the amounts arise from business activity of the patron. (These provisions do not apply to REA cooperatives.) Also, the act includes a provision permitting farmers to deduct, in computing their Federal income tax, expenditures incurred by them in clearing land to make it suitable for farming, up to \$5,000 or 25 percent of the taxable income from farming for the year, whichever is the lesser.

3. MINIMUM WAGE. By a vote of 65 to 28, passed with amendments H. R. 3935, to amend the Fair Labor Standards Act to provide for the coverage of additional workers and to increase the minimum wage gradually to \$1.25 an hour. pp. 5971, 5975-81, 5983-92, 6059-60

4. TAXATION; COOPERATIVES. Both Houses received the President's message on Federal taxation (H. Doc. 140) (pp. 5992-98, 6078-83). Regarding the taxation of cooperatives the President recommended "that the law be clarified so that all earnings are taxable to either the cooperatives or to their patrons, assessing the patron on the earnings that are allocated to him as patronage dividends or refunds in scrip or cash. The withholding principles recommended above should also be applied to patronage dividends or refunds so that the average patron receiving scrip will, in effect, be given the cash to pay his tax on his patronage dividend or refund The exemption for rural electric cooperatives and credit unions should be continued."

Several Senators commended the message. pp. 5999, 6022-3. 6029, 6047-8

5. ACREAGE ALLOTMENTS. Passed as reported S. 1372, to authorize the temporary release and reapportionment of pooled acreage allotments. p. 6018

6. NOMINATIONS. Confirmed the nomination of Howard Bertsch to be Administrator of Farmers Home Administration and the nominations of Julian B. Thayer and Joe B. Zeug to be members of the Federal Farm Credit Board, Farm Credit Administration. p. 5959

7. FARM HOUSING. Sen. Hartke commended the farm housing program, stating that there is an extensive and continuing need for this type of credit service to farm owners and that almost "1,500 applications were received during February, and this number was 45 percent greater than the number received during February last year." pp. 5972-3

8. PEACE CORPS. Sen. Kerr inserted the text of a factbook which attempts to answer some of the basic questions about the Peace Corps program. pp. 6019-21

9. PATENTS. Sen. Humphrey inserted an article, "Federal Contract Patent Policy and the Public Interest," which deals with the arguments for relinquishing title to patents, the real costs of relinquishing title, reasons why Government should take title, and the goals of our society as contrasted with the U. S. S. R. pp. 6048-54

10. RURAL DEVELOPMENT. Sen. Proxmire inserted two articles discussing industrial development of rural areas, "Rural Industry Agency is Freeman Objective" and "Rural Industry." pp. 6053-59

11. WATER POLLUTION. Sen. Morse inserted a memorial from the Oregon legislature endorsing the establishment of a Pollution Control Laboratory in the Pacific Northwest. p. 6066

12. ADJOURNED until Mon., Apr. 24. p. 6069

HOUSE

13. SURPLUS COMMODITIES; FOREIGN TRADE. The Rules Committee reported a resolution for consideration of H. R. 4728, to amend Public Law 480 so as to provide an additional authorization of \$2 billion during 1961 under title I for sales of surplus commodities for foreign currencies. p. 6084

14. FARM BILL. Rep. Schwengel criticized the conservation reserve program item in the new farm bill, saying "The very absence of constructive reference to this important subject might lead one to believe that conservation practices by the present administration have diminished in importance." p. 6134
15. COMMITTEE APPOINTMENTS. Reps. Colmer and Westland were appointed to the National Forest Reservation Commission.
Reps. Pfost, Rivers (Alaska), Saylor, and Kyl were appointed to the National Outdoor Recreation Resources Review Commission. p. 6078
16. LEGISLATIVE PROGRAM. Rep. McCormack announced that the conference report on S. 1, the depressed areas bill, will be considered on Wed., to be followed by consideration of H. R. 4728, to amend Public Law 480. pp. 6117-8
17. ADJOURNED until Mon., Apr. 24. p. 6144

ITEMS IN APPENDIX

18. WATER RESOURCES. Sen. Hartke inserted a speech by Sen. Kerr at the annual meeting of the Wabash Valley Association, Inc., on water conservation and resource development. pp. A2660-2
19. ST. LAWRENCE SEAWAY. Extension of remarks of Sen. Wiley expressing his opinion that expansion of traffic through the seaway offers great opportunity for economic growth and progress, and insertion of excerpts of his radio address on this subject. pp. A2663-5
20. TEXTILES. Extension of remarks of several Representatives expressing a need for restrictions on textile imports, and insertion of articles and statistical data to support their opinions. pp. A2665, A2703, A2706-7, A2714
21. WILDLIFE. Extension of remarks of Sen. Bartlett and insertion of an Alaska newspaper editorial commending the appointment of C. F. Pautzke as Commissioner of the U. S. Fish and Wildlife Service. pp. A2677-8
22. PEACE CORPS. Sen. Williams extended his remarks and inserted a newspaper article "South Orange Eighth Graders Form a Junior Peace Corps" and portions of a television transcript of comments of the Director of the Peace Corps concerning a "peace corps on the homefront." pp. A2681-2
23. NATURAL RESOURCES. Sen. Yarborough inserted an article "The National Conference on State Parks: Its History and Its Future," which he described as an excellent report on the work of this group and its interest and work in coordination with the national conservation efforts. pp. A2682-3
24. ECONOMICS. Extension of remarks of Rep. Curtis, Mo., and insertion of a Honolulu editor and publisher's address "The Economic Outlook On The New Frontier" which is somewhat critical of Government spending to get money in circulation and states that we are in urgent need of tax reform. pp. A2683-6
25. FEED GRAINS. Extension of remarks of Rep. Smith, Iowa, and insertion of an Iowa newspaper article which says that the new feed grains program is getting a lot of support from farmers. pp. A2708-10
26. FARM LABOR. Extension of remarks of Rep. Coad calling for support of his bill, H. R. 6032, which would amend the program under which Mexican braceros are

OUR FEDERAL TAX SYSTEM

M E S S A G E

FROM

THE PRESIDENT OF THE UNITED STATES

RELATIVE TO

OUR FEDERAL TAX SYSTEM

APRIL 20, 1961.—Referred to the Committee on Ways and Means and ordered to be printed

To the Congress of the United States:

A strong and sound Federal tax system is essential to America's future. Without such a system, we cannot maintain our defenses and give leadership to the free world. Without such a system, we cannot render the public services necessary for enriching the lives of our people and furthering the growth of our economy.

The tax system must be adequate to meet our public needs. It must meet them fairly, calling on each of us to contribute his proper share to the cost of government. It must encourage efficient use of our resources. It must promote economic stability and stimulate economic growth. Economic expansion in turn creates a growing tax base, thus increasing revenue and thereby enabling us to meet more readily our public needs, as well as our needs as private individuals.

This message recognizes the basic soundness of our tax structure. But it also recognizes the changing needs and standards of our economic and international position, and the constructive reform needs to keep our tax system up to date and to maintain its equity. Previous messages have emphasized the need for prompt congressional and executive action to alleviate the deficit in our international balance of payments—to increase the modernization, productivity, and competitive status of American industry—to stimulate the expansion and growth of our economy—to eliminate to the extent possible economic

injustice within our own society—and to maintain the level of revenues requested in my predecessor's budget. In each of these endeavors, tax policy has an important role to play and necessary tax changes are herein proposed.

The elimination of certain defects and inequities as proposed below will provide revenue gains to offset the tax reductions offered to stimulate the economy. Thus no net loss of revenue is involved in this set of proposals. I wish to emphasize here that they are a "set"—and that considerations of both revenue and equity, as well as the interrelationship of many of the proposals, urge their consideration as a unit.

I am instructing the Secretary of the Treasury to furnish the Committee on Ways and Means of the House a detailed explanation of these proposals in connection with their legislative consideration.

I. LONG-RANGE TAX REFORM

While it is essential that the Congress receive at this time this administration's proposals for urgent and obvious tax adjustments needed to fulfill the aims listed above, time has not permitted the comprehensive review necessary for a tax structure which is so complicated and so critically important to so many people. This message is but a first though urgent step along the road to constructive reform.

I am directing the Secretary of the Treasury, building on recent tax studies of the Congress, to undertake the research and preparation of a comprehensive tax reform program to be placed before the next session of the Congress.

Progressing from these studies, particularly those of the Committee on Ways and Means and the Joint Economic Committee, the program should be aimed at providing a broader and more uniform tax base, together with an appropriate rate structure. We can thereby work toward the goal of a higher rate of economic growth, a more equitable tax structure, and a simpler tax law. I know these objectives are shared by—and, at this particular time of year, acutely desired by—the vast majority of the American people.

In meeting the demands of war finance, the individual income tax moved from a selective tax imposed on the wealthy to the means by which the great majority of our citizens participates in paying for well over one-half of our total budget receipts. It is supplemented by the corporation income tax, which provides for another quarter of the total.

This emphasis on income taxation has been a sound development. But so many taxpayers have become so preoccupied with so many tax-saving devices that business decisions are interfered with, and the efficient functioning of the price system is distorted.

Moreover, special provisions have developed into an increasing source of preferential treatment to various groups. Whenever one taxpayer is permitted to pay less, someone else must be asked to pay more. The uniform distribution of the tax burden is thereby disturbed and higher rates are made necessary by the narrowing of the tax base. Of course, some departures from uniformity are needed to promote desirable social or economic objectives of overriding importance which can be achieved most effectively through the tax mechanism. But many of the preferences which have developed do

not meet such a test and need to be reevaluated in our tax reform program.

It will be a major aim of our tax reform program to reverse this process by broadening the tax base and reconsidering the rate structure. The result should be a tax system that is more equitable, more efficient, and more conducive to economic growth.

II. TAX INCENTIVE FOR MODERNIZATION AND EXPANSION

The history of our economy has been one of rising productivity, based on improvement in skills, advances in technology, and a growing supply of more efficient tools and equipment. This rise has been reflected in rising wages and standards of living for our workers, as well as a healthy rate of growth for the economy as a whole. It has also been the foundation of our leadership in world markets, even as we enjoyed the highest wage rates in the world.

Today, as we face serious pressure on our balance of payments position, we must give special attention to the modernization of our plant and equipment. Forced to reconstruct after wartime devastation, our friends abroad now possess a modern industrial system helping to make them formidable competitors in world markets. If our own goods are to compete with foreign goods in price and quality, both at home and abroad, we shall need the most efficient plant and equipment.

At the same time, to meet the needs of a growing population and labor force, and to achieve a rising per capita income and employment level, we need a high and rising level of both private and public capital formation. In my preceding messages, I have proposed programs to meet some of our needs for such capital formation in the public area, including investment in intangible capital such as education and research, as well as investment in physical capital such as buildings and highways. I am now proposing additional incentives for the modernization and expansion of private plant and equipment.

Inevitably, capital expansion and modernization—now frequently under the name of automation—alter established modes of production. Great benefits result and are distributed widely—but some hardships result as well. This places heavy responsibilities on public policy, not to retard modernization and capital expansion but to promote growth and ameliorate hardships when they do occur—to maintain a high level of demand and employment, so that those who are displaced will be reabsorbed quickly into new positions—and to assist in retraining and finding new jobs for such displaced workers. We are developing, through such measures as the area redevelopment bill and a strengthened Employment Service, as well as assistance to the unemployed, the programs designed to achieve these objectives.

High capital formation can be sustained only by a high and rising level of demand for goods and service. Indeed, the investment incentive itself can contribute materially to achieving the prosperous economy under which this incentive will make its maximum contribution to economic growth. Rather than delaying its adoption until all excess capacity has disappeared and unemployment is low, we should take this step now to strengthen our antirecession program, stimulate employment, and increase our export markets.

Additional expenditures on plant and equipment will immediately create more jobs in the construction, lumber, steel, cement, machinery, and other related capital goods industries. The staffing of these new plants—and filling the orders for new export markets—will require additional employees. The additional wages of these workers will help create still more jobs in consumer goods and service industries. The increase in jobs resulting from a full year's operation of such an incentive is estimated at about half a million.

Specifically, therefore, I recommend enactment of an investment tax incentive in the form of a tax credit of—

Fifteen percent of all new plant and equipment investment expenditures in excess of current depreciation allowances;

Six percent of such expenditures below this level but in excess of 50 percent of depreciation allowances; with

Ten percent on the first \$5,000 of new investment as a minimum credit.

This credit would be taken as an offset against the firm's tax liability, up to an overall limitation of 30 percent in the reduction of that liability in any one year. It would be separate from and in addition to depreciation of the eligible new investment at cost. It would be available to individually owned businesses as well as corporate enterprises, and apply to eligible investment expenditures made after January 1 of this year. To remain a real incentive and make a maximum contribution to those areas of capital expansion and modernization where it is most needed, and to permit efficient administration, eligible investment expenditures would be limited to expenditures on new plant and equipment, on assets located in the United States, and on assets with a life of 6 years or more. Investments by public utilities other than transportation would be excluded, as would be investment in residential construction including apartments and hotels.

Of the eligible firms, it is expected that many small firms would be able to take advantage of the minimum credit of 10 percent on the first \$5,000 of new investment which is designed to provide a helpful stimulus to the many small businesses in need of modernization. Other small firms, subject to a 30-percent tax rate, would strive to be eligible for the full 15-percent credit—the equivalent for such firms of a deduction from their gross income for tax purposes of 50 percent of the cost of new investment. Among the remaining firms, it is expected that a majority would be induced to make new investments in modern plant and equipment in excess of their depreciation in order to earn the 15-percent credit. New and growing firms would be particularly benefited. The 6-percent credit for those whose new investment expenditures fall between 50 and 100 percent of their depreciation allowances is designed to afford some substantial incentive to the depressed or hesitant firm which knows it cannot yet achieve the 15-percent credit.

In arriving at this form of tax encouragement to investment, careful consideration was given to other alternatives. If the credit were given across the board to all new investment, a much larger revenue loss would result from those expenditures which would have been undertaken anyway or represent no new level of effort. Our objective is to provide the largest possible inducement to new investment which would not otherwise be undertaken. Thus the plan

recommended above would involve the same revenue loss—approximately \$1.7 billion—as only a 7-percent credit across the board to all new investment.

The use of current depreciation allowances as the threshold above which the higher rate of credit would apply recommends itself for a number of reasons. Depreciation reflects the average level of investment over the past, but is a less restrictive and more stable test than the use of an average of investment expenditures for a period such as the preceding 5 years. In addition, the depreciation allowances themselves in effect supply tax-free funds for investment up to this level. We now propose a tax credit—which would help to secure funds needed for the additional investment beyond that level.

The proposed credit, in terms of the revenue loss involved, will also be much more effective as an inducement to investment than an outright reduction in the rate of corporation income tax. Its benefits would be distributed more broadly, since the proposed credit will apply to individuals and partnerships as well as corporations. It will also be more effective as a direct incentive to corporate investment, and increase available funds more specifically in those corporations most likely to use them for additional investment. In short, whereas the credit will have the advantage of focusing on the profitability of new investment, much of the revenue loss under a general corporate rate reduction would be diverted into raising the profitability of old investment.

It is true that this advantage of focusing entirely on new investment is shared by the alternative strongly urged by some—a tax change permitting more rapid depreciation of new assets (be it accelerated depreciation or an additional depreciation allowance for the first year). But the proposed investment credit would be superior, in my view, for a number of reasons. In the first place, the determination of the length of an asset's life and proper methods of depreciation have a normal and important function in determining taxable income, wholly apart from any considerations of incentive; and they should not be altered or manipulated for other purposes that would interfere with this function. It may be that on examination some of the existing depreciation rules will be found to be outmoded and inequitable; but that is a question that should be separated from investment incentives. A review of these rules and methods is underway in the Treasury Department as a part of its overall tax reform study to determine whether changes are appropriate and, if so, what form they should take. Adoption of the proposed incentive credit would in no way foreclose later action on these aspects of depreciation.

In the second place, an increase in tax depreciation tends to be recorded in the firm's accounts, thereby raising current costs and acting as a deterrent to price reduction. The proposed investment credit would not share this defect.

Finally, it is clear that the tax credit would be more effective in inducing new investment for the same revenue loss. The entire credit would be reflected immediately in the increased funds available for investment without increasing the company's future tax liability. A speedup in depreciation only postpones the timing of the tax liability on profits from the investment to a later date—an increase in profitability not comparable to that of an outright tax credit. Yet accelerated depreciation is much more costly in immediate revenues.

For example, on an average investment, a tax credit of 15 percent would bring the same return to the firm as an additional first year depreciation of over 50 percent of the cost of the investment. Yet the immediate revenue loss to the Treasury from such additional depreciation would be twice as much, and would remain considerably higher for many years. The incentive to new investment our economy needs, and which this recommendation would provide at a revenue loss of \$1.7 billion, could be supplied by an initial writeoff only at an immediate cost of \$3.4 billion.

I believe this investment tax credit will become a useful and continuous part of our tax structure. But it will be a new venture and remain in need of review. Moreover, it may prove desirable for the Congress to modify the credit from time to time so as to adapt it to the needs of a changing economy. I strongly urge its adoption in this session.

III. TAX TREATMENT OF FOREIGN INCOME

Changing economic conditions at home and abroad, the desire to achieve greater equity in taxation, and the strains which have developed in our balance of payments position in the last few years, compel us to examine critically certain features of our tax system which, in conjunction with the tax system of other countries, consistently favor U.S. private investment abroad compared with investment in our own economy.

1. *Elimination of tax deferral privileges in developed countries and "tax haven" deferral privileges in all countries.*—Profits earned abroad by American firms operating through foreign subsidiaries are, under present tax laws, subject to U.S. tax only when they are returned to the parent company in the form of dividends. In some cases, this tax deferral has made possible indefinite postponement of the U.S. tax; and, in those countries where income taxes are lower than in the United States, the ability to defer the payment of U.S. tax by retaining income in the subsidiary companies provides a tax advantage for companies operating through oversea subsidiaries that is not available to companies operating solely in the United States. Many American investors properly made use of this deferral in the conduct of their foreign investment. Though changing conditions now make continuance of the privilege undesirable, such change of policy implies no criticism of the investors who so utilize this privilege.

The undesirability of continuing deferral is underscored where deferral has served as a shelter for tax escape through the unjustifiable use of tax havens such as Switzerland. Recently more and more enterprises organized abroad by American firms have arranged their corporate structures—aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices which maximize the accumulation of profits in the tax haven—so as to exploit the multiplicity of foreign tax systems and international agreements in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad.

To the extent that these tax havens and other tax deferral privileges result in U.S. firms investing or locating abroad largely for tax reasons, the efficient allocation of international resources is upset, the initial drain on our already adverse balance of payments is never fully com-

persated, and profits are retained and reinvested abroad which would otherwise be invested in the United States. Certainly since the post-war reconstruction of Europe and Japan has been completed, there are no longer foreign policy reasons for providing tax incentives for foreign investment in the economically advanced countries.

If we are seeking to curb tax havens, if we recognize that the stimulus of tax deferral is no longer needed for investment in the developed countries, and if we are to emphasize investment in this country in order to stimulate our economy and our plant modernization, as well as ease our balance of payments deficit, we can no longer afford existing tax treatment of foreign income.

I therefore recommend that legislation be adopted which would, after a two-step transitional period, tax each year American corporations on their current share of the undistributed profits realized in that year by subsidiary corporations organized in economically advanced countries. This current taxation would also apply to individual shareholders of closely held corporations in those countries. Since income taxes paid abroad are properly a credit against the U.S. income tax, this would subject the income from such business activities to essentially the same tax rates as business activities conducted in the United States. To permit firms to adjust their operations to this change, I also recommend that this result be achieved in equal steps over a 2-year period, under which only one-half of the profits would be affected during 1962. Where the foreign taxes paid have been close to the U.S. rates, the impact of this change would be small.

This proposal will maintain U.S. investment in the developed countries at the level justified by market forces. American enterprise abroad will continue to compete with foreign firms. With their access to capital markets at home and abroad, their advanced technical know-how, their energy, resourcefulness, and many other advantages, American firms will continue to occupy their rightful place in the markets of the world. While the rate of expansion of some American business operations abroad may be reduced through the withdrawal of tax deferral such reduction would be consistent with the efficient distribution of capital resources in the world, our balance of payments needs, and fairness to competing firms located in our own country.

At the same time, I recommend that tax deferral be continued for income from investment in the developing economies. The free world has a strong obligation to assist in the development of these economies, and private investment has an important contribution to make. Continued income tax deferral for these areas will be helpful in this respect. In addition, the proposed elimination of income tax deferral on U.S. earnings in industrialized countries should enhance the relative attraction of investment in the less developed countries.

On the other hand, I recommend elimination of the tax haven device anywhere in the world, even in the underdeveloped countries, through the elimination of tax deferral privileges for those forms of activities, such as trading, licensing, insurance, and others, that typically seek out tax haven methods of operation. There is no valid reason to permit their remaining untaxed regardless of the country in which they are located.

2. *Taxation of foreign investment companies.*—For some years now we have witnessed substantial outflows of capital from the United

States into investment companies created abroad whose principal justification lies in the tax benefits which their method of operation produces. I recommend that these tax benefits be removed and that income derived through such foreign investment companies be treated in substantially the same way as income from domestic investment companies.

3. *Taxation of American citizens abroad.*—It is no more justifiable to provide tax exemptions for individuals living in the developed countries than it is to provide tax inducements for capital investment there. Nor should we permit totally unjustified tax benefits to be obtained by those Americans whose choice of residence is dictated primarily by their desire to minimize taxes.

I, therefore, recommend—

That the total tax exemption now accorded the earned income of American citizens residing abroad be completely terminated for those residing in economically advanced countries;

That this exemption for earned income be limited to \$20,000 for those residing in the less developed countries; and

That the exemption of \$20,000 of earned income now accorded those citizens who stay (but do not reside) abroad for 17 out of 18 months also be completely terminated for those living or traveling in the economically advanced countries.

4. *Estate tax on property located abroad.*—I recommend that the exclusion from the estate tax accorded real property situated abroad be terminated. With the adoption several years ago of the credit for foreign taxes under the estate tax, there is no justification for the continued exemption of such property.

5. *Allowance for foreign tax on dividends.*—Finally, the method by which the credit for foreign income taxes is computed in the case of dividends involves a double allowance for foreign income taxes and should be corrected.

These proposals, along with more detailed and technical changes needed to improve the taxation of foreign income, are expected to reduce substantially our balance-of-payments deficit and to increase revenues by at least \$250 million per year.

IV. CORRECTION OF OTHER STRUCTURAL DEFECTS

I next recommend a number of measures to remove other serious defects in the income tax structure. These changes, while making a beginning toward the comprehensive tax reform program mentioned above, will provide sufficient revenue gains to offset the cost of the investment tax credit and keep the revenue-producing potential of our tax structure intact.

1. *Withholding on interest and dividends.*—Our system of combined withholding and voluntary reporting on wages and salaries under the individual income tax has served us well. Introduced during the war when the income tax was extended to millions of new taxpayers, the wage-withholding system has been one of the most important and successful advances in our tax system in recent times. Initial difficulties were quickly overcome, and the new system helped the taxpayer no less than the tax collector.

It is the more unfortunate, therefore, that the application of the withholding principle has remained incomplete. Withholding does

not apply to dividends and interest, with the result that substantial amounts of such income, particularly interest, improperly escape taxation. It is estimated that about \$3 billion of taxable interest and dividends are unreported each year. This is patently unfair to those who must as a result bear a larger share of the tax burden. Recipients of dividends and interest should pay their tax no less than those who receive wage and salary income, and the tax should be paid just as promptly. Large continued avoidance of tax on the part of some has a steadily demoralizing effect on the compliance of others.

This gap in reporting has not been appreciably lessened by educational programs. Nor can it be effectively closed by intensified enforcement measures, except by the expenditure of inordinate amounts of time and money. Withholding on corporate dividends and on investment-type interest, such as interest paid on taxable government and corporate securities and savings accounts, is both necessary and practicable.

I, therefore, recommend the enactment of legislation to provide for a 20-percent withholding rate on corporate dividends and taxable investment-type interest, effective January 1, 1962, under a system which would not require the preparation of withholding statements to be sent to recipients. It would thus place a relatively light burden of compliance on the payers of interest and dividends—certainly less than that placed on payers of wages and salaries—while at the same time largely solving the compliance problem for most of the taxpayers receiving dividends and interest. Steps will also be taken to avoid hardships for recipients who are not subject to tax.

The remaining need for compliance, largely in the high income group subject to a higher tax rate, would be met through the concentration of enforcement devices on taxpayers in these brackets. Introduction of equipment for the automatic processing of information returns would be especially helpful for this purpose and would thus supplement the extension of withholding.

Enactment of this proposal is estimated to increase revenue by \$600 million per year.

2. *Repeal of the dividend credit and exclusion.*—The present law provides for an exclusion from income of the first \$50 of dividends received from domestic corporations, and for a 4-percent credit against tax of such dividend income in excess of \$50. These provisions were enacted in 1954. Proponents argued that they would encourage capital formation through equity investment, and that they would provide a partial offset to the so-called double taxation of dividend income. It is now clear that they serve neither purpose well; and I, therefore, recommend the repeal of both the dividend credit and exclusion.

The dividend credit and exclusion are not an efficient stimulus to capital expansion in the form of plant and equipment. The revenue losses resulting from these provisions are spread over a large volume of outstanding shares rather than being concentrated on new shares; and the stimulating effects of the provisions are thus greatly diluted, resulting in relatively little increases in the supply of equity funds and a relatively slight reduction in the cost of equity financing. In fact, such reduction as does occur is more likely to benefit large corporations with easy access to the capital market, while being of little use to small firms which are not so favorably situated. Insofar as raising the

profitability of new investment in plant and equipment is concerned, the tax investment credit proposed above would be far more effective since it is offered to the corporation, where the actual investment decision is made.

The dividend credit and exclusion are equally inadequate as a solution to the so-called problem of double taxation. Whatever may be the merits of the arguments respecting the existence of double taxation, the provisions of the 1954 act clearly do not offer an appropriate remedy. They greatly overcompensate the dividend recipient in the high income bracket, while giving either insufficient or no relief to shareholders with smaller income.

This point deserves emphasis. For viewed simply as a means of tax reduction, the dividend credit is wholly inequitable. The distribution of its benefits is highly favorable to the taxpayers in the upper income groups who receive the major part of dividend income. Only about 10 percent of dividend income accrues to those with incomes below \$5,000; about 80 percent of it accrues to that 6.5 percent of taxpayers whose incomes exceed \$10,000 a year. Similarly, dividend income is a sharply rising fraction of total income as we move up the income scale. Thus, dividend income is about 1 percent of all income from all sources for those taxpayers with incomes of \$3,000 to \$5,000; but it constitutes more than 25 percent of the income for those with \$100,000 to \$150,000 of income, and about 50 percent for those with incomes over \$1 million.

The role of the dividend credit should not be confused with the broader question of tax rates applicable to high incomes. These high rates deserve reexamination; and this is one of the problems which will be examined in the context of next year's tax reform. But if top bracket rates were to be reduced, the dividend credit is not the way to do it. Rate reductions, if appropriate, should apply no less to those with high incomes from other sources, such as professional and salaried people whose tax position is particularly difficult today.

If the credit is eliminated, the \$50 exclusion should also be discarded for similar reasons. The tax saving from the exclusion is substantially greater for a dividend recipient with a high income than for a recipient with low income. Moreover, on equity grounds, there is no reason for giving tax reduction to that small fraction of low-income taxpayers who receive dividends in contrast to those who must live on wages, interest, rents or other forms of income.

The 1954 formula therefore is a dead end and should be rescinded, effective December 31 of this year. The estimated revenue gain is \$450 million per year.

3. *Expense accounts.*—In recent years widespread abuses have developed through the use of the expense account. Too many firms and individuals have devised means of deducting too many personal living expenses as business expenses, thereby charging a large part of their cost to the Federal Government. Indeed, expense account living has become a byword in the American scene.

This is a matter of national concern, affecting not only our public revenues, our sense of fairness, and our respect for the tax system, but our moral and business practices as well. This widespread distortion of our business and social structure is largely a creature of the tax system, and the time has come when our tax laws should cease their

encouragement of luxury spending as a charge on the Federal Treasury. The slogan—"It's deductible"—should pass from our scene.

Tighter enforcement of present legislation will not suffice. Even though in some instances entertainment and related expenses have an association with the needs of business, they nevertheless confer substantial tax-free personal benefits to the recipients. In other cases, deductions are obtained by disguising personal expenses as business outlays. But under present law, it is extremely difficult to separate out and disallow such pseudobusiness expenditures. New legislation is needed to deal with the problem.

I, therefore, recommend that the cost of such business entertainment and the maintenance of entertainment facilities (such as yachts and hunting lodges) be disallowed in full as a tax deduction and that restrictions be imposed on the deductibility of business gifts, expenses of business trips combined with vacations, and excessive personal living expenses incurred on business travel away from home.

I feel confident that these measures will be welcomed by the American people. I am also confident that business firms, now forced to emulate the expense account favors of their competitors, however unsound or uneconomical such practices may be, will welcome the removal of this pressure. These measures will strengthen both our tax structure and the moral fiber of our society. These provisions should be effective as of January 1, 1962, and are estimated to increase Treasury receipts by at least \$250 million per year.

4. *Capital gains on sale of depreciable business property.*—Another flaw which should be corrected at this time relates to the taxation of gains on the sale of depreciable business property. Such gains are now taxed at the preferential rate applicable to capital gains, even though they represent ordinary income.

This situation arises because the statutory rate of depreciation may not coincide with the actual decline in the value of the asset. While the taxpayer holds the property, depreciation is taken as a deduction from ordinary income. Upon its resale, where the amount of depreciation allowable exceeds the decline in the actual value of the asset so that a gain occurs, this gain under present law is taxed at the preferential capital gains rate. The advantages resulting from this practice have been increased by the liberalization of depreciation rates.

Our capital gains concept should not encompass this kind of income. This inequity should be eliminated, and especially so in view of the proposed investment credit. We should not encourage through tax incentives the further acquisition of such property as long as this loophole remains.

I therefore recommend that capital gains treatment be withdrawn from gains on the disposition of depreciable property, both personal and real property, to the extent that depreciation has been deducted for such property by the seller in previous years, permitting only the excess of the sales price over the original cost to be treated as a capital gain. The remainder should be treated as ordinary income. This reform should immediately become effective as to all sales taking place after the date of enactment. It is estimated to raise revenue by \$200 million annually.

5. *Cooperatives and financial institutions.*—Another area of the tax laws which calls for attention is the treatment of cooperatives, private lending institutions, and fire and casualty insurance companies.

Contrary to the intention of Congress, substantial income from certain cooperative enterprises, reflecting business operations, is not being taxed either to the cooperative organization itself or its members. This situation must be corrected in a manner that is fair and just to both the cooperatives and competing businesses.

The present inequity has resulted from court decisions which held patronage refunds in certain forms to be nontaxable. I recommend that the law be clarified so that all earnings are taxable to either the cooperatives or to their patrons, assessing the patron on the earnings that are allocated to him as patronage dividends or refunds in scrip or cash. The withholding principle recommended above should also be applied to patronage dividends or refunds so that the average patron receiving scrip will, in effect, be given the cash to pay his tax on his patronage dividend or refund. The cooperatives should not be penalized by the assessment of a patronage tax upon dividends or refunds taxable to the patron but left in the business as a substitute for the sale of securities to obtain additional equity capital. The exemption for rural electric cooperatives and credit unions should be continued.

The tax provisions applicable to fire and casualty insurance companies, originally adopted in 1942, need to be reviewed in the light of current conditions. Many of these companies, organized on the mutual or reciprocal basis are now taxed under a special formula which does not take account of their underwritings gains and thus results in an inequitable distribution of the tax burden among various types of companies. Consideration should be given to taxing mutual or reciprocal companies on a basis similar to stock companies, following the pattern of similar treatment of stock and mutual enterprise in the life insurance field.

Some of the most important types of private savings and lending institutions in the country are accorded tax deductible reserve provisions which substantially reduce or eliminate their Federal income tax liability. These provisions should be reviewed with the aim of assuring nondiscriminatory treatment.

Remedial legislation in these fields would enlarge the revenues and contribute to a fair and sound tax structure.

V. TAX ADMINISTRATION

One of the major characteristics of our tax system, and one in which we can take a great deal of pride, is that it operates primarily through individual self-assessment. The integrity of such a system depends upon the continued willingness of the people honestly and accurately to discharge this annual price of citizenship. To the extent that some people are dishonest or careless in their dealings with the Government, the majority is forced to carry a heavier tax burden.

For voluntary self-assessment to be both meaningful and productive of revenues, the citizens must not only have confidence in the fairness of the tax laws, but also in their uniform and vigorous enforcement of these laws. If noncompliance by the few continues unchecked, the

confidence of the many in our self-assessment system will be shaken and one of the cornerstones of our Government weakened.

I have in this message already recommended the application of withholding to dividends and interest and revisions to halt the abuses of expense accounts. These measures will improve taxpayer compliance and raise the regard of taxpayers for the fairness of our system. In addition, I propose three further measures to improve the tax enforcement machinery.

1. *Taxpayer account numbers.*—The Internal Revenue Service has begun the installation of automatic data processing equipment to improve administration of the growing job of tax collection and enforcement. A system of identifying taxpayer account numbers, which would make possible the bringing together of all tax data for any one particular taxpayer, is an essential part of such an improved collection and enforcement program.

For this purpose, social security numbers would be used by taxpayers already having them. The small minority currently without such numbers would be assigned numbers which these persons could later use as well for social security purposes if needed. The numbers would be entered on tax returns, information returns, and related documents.

I recommend that legislation be enacted to authorize the use of taxpayer account numbers beginning January 1, 1962, to identify taxpayer accounts throughout the processing and recordkeeping operations of the Internal Revenue Service.

2. *Increased audit coverage.*—The examination of tax returns is the essence of the enforcement process. The number of examining personnel of the Internal Revenue Service, however, has been consistently inadequate to cope with the audit workload. Consequently, it has been unable to audit carefully many of the returns which should be so examined. Anticipated growth in our population will, of course, increase this enforcement problem.

Related to broadened tax audit is the criminal enforcement program of the Revenue Service. Here, the guiding principle is the creation of a deterrent to tax evasion and to maintain or, if possible, increase voluntary compliance with all taxing statutes. This means placing an appropriate degree of investigative emphasis on all types of tax violations, in all geographical areas, and identifying violations of substance in all income brackets regardless of occupation, business, or profession.

Within this framework of a balanced enforcement effort, the Service is placing special investigative emphasis on returns filed by persons receiving income from illegal sources. I have directed all Federal law enforcement agencies to cooperate fully with the Attorney General in a drive against organized crime, and to utilize their resources to the maximum extent in conducting investigations of individuals engaged in criminal activity on a major scale. With the foregoing in mind, I have directed the Secretary of the Treasury to provide through the Internal Revenue Service a maximum effort in this field.

To fulfill these requirements for improved audits, enforcement and anticrime investigation, it is essential that the Service be provided additional resources which will pay their own cost many times over. In furthering the Service's long-range plans, the prior administration asked additional appropriations of \$27.4 million to hire about 3,500

additional personnel during fiscal 1962, including provisions for the necessary increases in space and modern equipment vital to the efficient operation of the Service. To meet the commitments described above, this administration reviewed these proposals and recommended that they be increased by another \$7 million and 765 additional personnel to expedite the expansion and criminal enforcement programs. The pending alternative of only 1,995 additional personnel, or less than one-half of the number requested, this administration would constitute little more than the additional employees needed each year during the 1960's just to keep up with the estimated growth in number and complexity of returns filed. Thus I must again strongly urge the Congress to give its full support to my original request. These increases will safeguard the long-term adequacy of the Nation's traditional voluntary compliance system and, at the same time, return the added appropriations several times over in added revenue.

3. *Inventory reporting.*—It is increasingly apparent that the manipulation of inventories has become a frequent method of avoiding taxes. Current laws and regulations generally permit the use of inventory methods which are acceptable in recognized accounting practice. Deviations from these methods, which are not always easy to detect during examination of tax returns, can often lead to complete non-payment of taxes until the inventories are liquidated; and, for some taxpayers, this represents permanent tax reduction. The understating of the valuation of inventories is the device most frequently used.

I have directed the Internal Revenue Service to give increasing attention to this area of tax avoidance, through a stepped-up emphasis on both the verification of the amounts reported as inventories and an examination of methods used in arriving at their reported valuation.

VI. TAX RATE EXTENSION

As recommended by my predecessor, it is again necessary that Congress enact an extension of present corporation income and excise tax rates otherwise scheduled for reduction or termination on July 1, 1961. Such extension has been adopted by the Congress on a number of previous occasions, and our present revenue requirements make such extension absolutely necessary again this year.

In the absence of such legislation, the corporate tax rate would be decreased 5 percentage points, from 52 percent to 47 percent, excise tax rates on distilled spirits, beer, wines, cigarettes, passenger automobiles, automobile parts and accessories, and the transportation of persons would also decline; and the excise tax on general telephone service would expire. We cannot afford the loss of these revenues at this time.

VII. AVIATION FUEL

The last item on the agenda relates to aviation fuel. The two previous administrations have urged that civil aviation, a mature and growing industry, be required to pay a fair share of the costs of operating and improving the Federal airways system. The rapidly mounting costs of these essential services to air transportation makes the imposition of user charges more imperative now than ever before. The most efficient method for recovering a portion of these costs equitably from the airway users is through a tax on aviation fuel.

Present law provides for a net tax of 2 cents a gallon on aviation gasoline but no tax on jet fuel. The freedom from tax on jet fuel is inequitable and is resulting in substantial revenue losses due to the transition to jet power and the resulting decline in gasoline consumption.

My predecessor recommended a flat 4½-cent tax for both aviation gasoline and jet fuels. Such a request, however, appears to be unrealistic in view of the current financial condition of the airline industry.

Therefore, I recommend—

Extending the present net 2-cent rate on aviation gasoline to jet fuels;

Holding this uniform rate covering both types of fuel at the 2-cent level for fiscal 1962; and

Providing for annual increments in this rate of one-half cent after fiscal year 1962 until the portion of the cost of the airways properly allocable to civil aviation is substantially recovered by this tax.

The immediate increase in revenue from this proposal is modest in comparison with anticipated airways costs; and the annual gradation of further increases is intended to moderate the impact of the tax on the air carrier industry. Should future economic or other developments warrant, a more rapid increase in the fuel tax will be recommended. The decline from the revenues estimated by my predecessor is not large, and will be met by the reforms previously proposed. I repeat my earlier recommendation that, consistent with the user charge principle, revenues from the aviation fuels tax be retained in the general fund rather than diverted to the highway trust fund.

CONCLUSION

The legislation recommended in this message offers a first step toward the broader objective of tax reform. The immediate need is for encouraging economic growth through modernization and capital expansion, and to remove tax preferences for foreign investment which are no longer needed and which impair our balance of payments position. A beginning is made also toward removing some of the more glaring defects in the tax structure. The revenue gain in these proposals will offset the revenue cost of the investment credit. Finally, certain rate extensions are needed to maintain the revenue potential of our fiscal system.

These items need to be done now; but they are a first step only. They will be followed next year by a second set of proposals, aimed at thorough income tax reform. Their purpose will be to broaden and unify the income tax base, and to review the entire rate structure in the light of these revisions. Let us join in solving these immediate problems in the coming months, and then join in further action to strengthen the foundations of our revenue system.

JOHN F. KENNEDY.

THE WHITE HOUSE, *April 20, 1961.*

fishing operations, including the going to and returning from work and loading and unloading when performed by any such employee; or

"(6) any employee employed in agriculture or in connection with the operation or maintenance of ditches, canals, reservoirs, or waterways, not owned or operated for profit, or operated on a share-crop basis, and which are used exclusively for supply and storing of water for agricultural purposes; or

"(7) any employee to the extent that such employee is exempted by regulations or orders of the Secretary issued under section 14; or

"(8) any employee employed in connection with the publication of any weekly, semiweekly, or daily newspaper with a circulation of less than four thousand the major part of which circulation is within the county where printed and published or counties contiguous thereto; or

"(9) any employee of a retail or service establishment who is employed primarily in connection with the preparation or offering of food or beverages for human consumption, either on the premises or by such services as catering, banquet, box lunch, or curb or counter service, to the public, to employees, or to members or guests of members of clubs; or

"(10) an individual employed within the area of production (as defined by the Secretary), engaged in handling, packing, storing, compressing, pasteurizing, drying, preparing in their raw or natural state, or canning of agricultural or horticultural commodities for market, or in making cheese or butter or other dairy products; or

"(11) any switchboard operator employed by an independently owned public telephone company which has not more than seven hundred and fifty stations; or

"(12) any employee of an employer engaged in the business of operating taxicabs; or

"(13) any employee or proprietor in a retail or service establishment which qualifies as an exempt retail or service establishment under clause (2) of this subsection with respect to whom the provisions of sections 6 and 7 would not otherwise apply, engaged in handling telegraphic messages for the public under an agency or contract arrangement with a telegraph company where the telegraph message revenue of such agency does not exceed \$500 a month; or

"(14) any employee employed as a seaman on a vessel other than an American vessel; or

"(15) any employee employed in planting or tending trees, cruising, surveying, or felling timber, or in preparing or transporting logs or other forestry products to the mill, processing plant, railroad, or other transportation terminal, if the number of employees employed by his employer in such forestry or lumbering operations does not exceed twelve; or

"(16) any employee with respect to his employment in agriculture by a farmer, notwithstanding other employment of such employee in connection with livestock auction operations in which such farmer is engaged as an adjunct to the raising of livestock, either on his own account or in conjunction with other farmers, if such employee (1) is primarily employed during his workweek in agriculture by such farmer, and (2) is paid for his employment in connection with such livestock auction operations at a wage rate not less than that prescribed by section 6(a)(1); or

"(17) any employee employed within the area of production (as defined by the Secretary) by an establishment commonly recognized as a country elevator, including such an establishment which sells products and services used in the operation of a farm:

Provided, That no more than five employees are employed in the establishment in such operations; or

"(18) any employee engaged in ginning of cotton for market, in any place of employment located in a county where cotton is grown in commercial quantities.

"(b) The provisions of section 7 shall not apply with respect to—

"(1) any employee with respect to whom the Interstate Commerce Commission has power to establish qualifications and maximum hours of service pursuant to the provisions of section 204 of the Motor Carrier Act, 1935; or

"(2) any employee of an employer subject to the provisions of part I of the Interstate Commerce Act; or

"(3) any employee of a carrier by air subject to the provisions of title II of the Railway Labor Act; or

"(4) any employee employed in the canning, processing, marketing, freezing, curing, storing, packing for shipment, or distributing of any kind of fish, shellfish, or other aquatic forms of animal or vegetable life, or any byproduct thereof; or

"(5) any individual employed as an outside buyer of poultry, eggs, cream, or milk in their raw or natural state; or

"(6) any employee employed as a seaman; or

"(7) any employee of a street, suburban, or interurban electric railway, or local trolley or motorbus carrier, not included in other exemptions contained in this section; or

"(8) any employee of a gasoline service station; or

"(9) any employee employed as an announcer, news editor, or chief engineer by a radio or television station having its major studio in a city or town which has a population of not more than fifty thousand, according to the latest available decennial census figures as compiled by the Bureau of the Census, if such city or town is not part of a standard metropolitan statistical area (as defined and designated by the Bureau of the Budget), having a total population in excess of fifty thousand, or if such city is a part of such an area but has a population of not more than twenty-five thousand and such station's major studio is at least forty airline miles from the principal city in such area; or

"(10) any employee of an independently owned and controlled local enterprise (including an enterprise with more than one bulk storage establishment) engaged in the wholesale or bulk distribution of petroleum products if (A) the annual gross volume of sales of such enterprise is not more than \$1,000,000 exclusive of excise taxes, and (B) more than 75 per centum of such enterprise's annual dollar volume of sales is made within the State in which such enterprise is located, and (C) not more than 25 per centum of the annual dollar volume of sales of such enterprise is to customers who are engaged in the bulk distribution of such products for resale; or

"(11) any employee of a retail or service establishment primarily engaged in the business of selling automobiles, trucks, or farm implements; or

"(12) any employee employed as a driver or driver's helper making local deliveries, who is compensated for such employment on the basis of trip rates, or other delivery payment plan, if the Secretary shall find that such plan has the general purpose and effect of reducing hours worked by such employees to, or below, the maximum workweek applicable to them under section 7(a)."

"Sec. 10. That section 13(d) of such Act, as amended, is amended by inserting before the period at the end thereof the following: 'or to any homemaker engaged in the mak-

ing of wreaths composed principally of natural holly, pine, cedar, or other evergreens (including the harvesting of the evergreens or other forest products used in making such wreaths)'.

"EMPLOYMENT OF STUDENTS

"Sec. 11. Clause (1) of section 14 of such Act is amended by striking out 'and' after 'apprentices,' and by inserting after 'messages,' the following: 'and of full-time students outside of their school hours in any retail or service establishment: *Provided*, That such employment is not of the type ordinarily given to a full-time employees.'

"PENALTIES AND INJUNCTION PROCEEDINGS

"Sec. 12. (a) Section 16(b) of such Act is amended by adding at the end thereof a new sentence as follows: 'The right provided by this subsection to bring an action by or on behalf of any employee, and the right of any employee to become a party plaintiff to any such action, shall terminate upon the filing of a complaint by the Secretary of Labor in an action under section 17 in which restraint is sought of any further delay in the payment of unpaid minimum wages, or the amount of unpaid overtime compensation, as the case may be, owing to such employee under section 6 or section 7 of this Act by an employer liable therefor under the provisions of this subsection.'

"(b) Section 17 of such Act is amended to read as follows:

"INJUNCTION PROCEEDINGS

"Sec. 17. The district courts, together with the United States District Court for the District of the Canal Zone, the District Court of the Virgin Islands, and the District Court of Guam shall have jurisdiction, for cause shown, to restrain violations of section 15, including in the case of violations of section 15(a)(2) the restraint of any withholding of payment of minimum wages or overtime compensation found by the court to be due to employees under this Act (except sums which employees are barred from recovering, at the time of the commencement of the action to restrain the violations, by virtue of the provisions of section 6 of the Portal-to-Portal Act of 1947).'

"STUDY OF AGRICULTURAL HANDLING AND PROCESSING EXEMPTIONS AND RATES OF PAY IN HOTELS, MOTELS, RESTAURANTS, AND OTHER FOOD SERVICE ENTERPRISES

"Sec. 13. The Secretary of Labor shall study the complicated system of exemptions now available for the handling and processing of agricultural products under such Act and particularly sections 7(c), 13(a)(10) and 7(b)(3), and the complex problems involving rules of pay of employees in hotels, motels, restaurants, and other food service enterprises who are exempted from the provisions of this Act and shall submit to the second session of the Eighty-seventh Congress at the time of his report under section 4(d) of such Act a special report containing the results of such study and information, data, and recommendations for further legislation designed to simplify and remove the inequities in the application of such exemptions.

"EFFECTIVE DATE

"Sec. 14. The amendments made by this Act shall take effect upon the expiration of one hundred and twenty days after the date of its enactment except as otherwise provided in such amendments and except that the authority to promulgate necessary rules, regulations, or orders with regard to amendments made by this Act, under the Fair Labor Standards Act of 1938 and amendments thereto, including amendments made by this Act, may be exercised by the Secretary on and after the date of enactment of this Act."

Mrs. NEUBERGER. Mr. President, I move that the vote by which the bill was passed be reconsidered.

Mr. HUMPHREY. Mr. President, I move that the motion to reconsider be laid on the table.

The PRESIDING OFFICER. The question is on agreeing to the motion to lay on the table the motion to reconsider.

The motion to lay on the table was agreed to.

Mr. RANDOLPH subsequently said: Mr. President, Robert G. Ingersoll, in an oration, once said:

The past rises before me like a dream. Again we are in the great struggle for national life.

I hope it is not too nostalgic to recall events of 23 years ago in Congress, when the Fair Labor Standards Act of 1938 became law. Only 15 Members of the Senate in the present session who were serving either in the House of Representatives or in the Senate in the 75th Congress, participated in the passage of the original act.

In the Senate today we have serving with us the Senator from New Mexico [Mr. CHAVEZ] and the Senator from Louisiana [Mr. ELLENDER] who were serving in this body in the 75th Congress. They voted for the original Fair Labor Standards Act. Two Senators still serving in the Senate, the Senator from Virginia [Mr. BYRD] and the Senator from New Hampshire [Mr. BRIDGES], voted against the original act.

Also still serving in the Senate now are the Senator from Arizona [Mr. HAYDEN] and the Senator from Georgia [Mr. RUSSELL], who, according to the RECORD, did not vote on the measure in 1938.

At that time, the vote in Senate favorable to the passage of the Fair Labor Standards Act was 56 to 28. Today, H.R. 3935, which is amendatory of the Fair Labor Standards Act, passed the Senate by a vote of 65 to 28.

Senators who are now serving in this body but who were Members of the House of Representatives in 1938 are: The senior Senator from Washington [Mr. MAGNUSON], the senior Senator from Alabama [Mr. HILL], the junior Senator from Illinois [Mr. DIRKSEN], and the senior Senator from West Virginia. In 1938, we voted for the Fair Labor Standards Act.

The junior Senator from Kansas [Mr. CARLSON], the junior Senator from South Dakota [Mr. CASE], the senior Senator from Arkansas [Mr. McCLELLAN], the junior Senator from Virginia [Mr. ROBERTSON], and the junior Senator from Alabama [Mr. SPARKMAN], as Members of the House of Representatives in 1938, voted against the Fair Labor Standards Act in that year. However, the Senator from Alabama [Mr. SPARKMAN], although he opposed the bill in the House, voted for the conference report.

So six Members of the Senate in 1938, who are still Members of this body, participated then in the passage of the Fair Labor Standards Act and participated in the consideration of the amendment to that act today.

Nine Members of the House in 1938, who are now serving in the Senate, participated in the other body and now in this body in the consideration and the passage of the Fair Labor Standards Act and the amendment thereof.

I hope it is not too nostalgic to indicate that the 15 present Senators who were then Members of the House, together with Senators now serving, is a rather small participation of Senators who voted today and also voted in the House in 1938.

Mr. President, as a Member of the House of Representatives when the Fair Labor Standards Act was before that body in the 75th Congress, I said during debate:

I rise, therefore, with the firm conviction in my own heart that the establishment of the principle is absolutely necessary at the present time.

I feel today as I did then about the importance of such a law. Our action now is a further strengthening influence in our growing economy. Conditions have changed and we have again met the responsibility to improve the original act.

Mr. President, I ask unanimous consent that my remarks may appear immediately following the yea-and-nay vote taken earlier this afternoon on H.R. 3935.

The PRESIDING OFFICER. Without objection, it is so ordered.

Mr. RUSSELL subsequently said: Mr. President, I desire to make an observation with respect to the passage of the wage and hour bill. I am inspired to make the observation by a statement made by the distinguished majority leader immediately prior to the vote, in which he congratulated the Senate and several individual Members thereof on the progress of the debate and the tone of the discussion. I was unable to get the floor immediately after the vote, so I make this statement *nunc pro tunc*.

I, too, wish to compliment the Senate. We have made a notable contribution to the space age. We have risen to dizzy heights of statesmanship, of which none of our predecessors would ever have dreamed, much less ever have aspired to.

We have brought within the grasp of every citizen of the Nation a new feeling of power and have brought romance into the drudgery of the work of every housewife. Every member of every household will now have the opportunity to feel that he is truly a citizen of this Republic. He can have the thrill of having affected the flow of commerce among the great States of the Union merely by sending the old man's shirt out to be washed at the laundry. [Laughter.]

THE FEDERAL TAX SYSTEM—MESSAGE FROM THE PRESIDENT (H. DOC. NO. 140)

Mr. MANSFIELD. Mr. President, the President's message on taxation was transmitted to the Senate today. The message has been read in the House of Representatives. I ask unanimous consent that the message be laid before the

Senate, be appropriately referred, and printed in the RECORD without being read.

The PRESIDING OFFICER. The Chair lays before the Senate the message on taxation from the President of the United States. Is there objection to the request of the Senator from Montana? The Chair hears none, and it is so ordered.

The message from the President was referred to the Committee on Finance, as follows:

To the Congress of the United States:

A strong and sound Federal tax system is essential to America's future. Without such a system, we cannot maintain our defenses and give leadership to the free world. Without such a system, we cannot render the public services necessary for enriching the lives of our people and furthering the growth of our economy.

The tax system must be adequate to meet our public needs. It must meet them fairly, calling on each of us to contribute his proper share to the cost of government. It must encourage efficient use of our resources. It must promote economic stability and stimulate economic growth. Economic expansion in turn creates a growing tax base, thus increasing revenue and thereby enabling us to meet more readily our public needs, as well as our needs as private individuals.

This message recognizes the basic soundness of our tax structure. But it also recognizes the changing needs and standards of our economic and international position, and the constructive reform needs to keep our tax system up to date and to maintain its equity. Previous messages have emphasized the need for prompt congressional and executive action to alleviate the deficit in our international balance of payments—to increase the modernization, productivity and competitive status of American industry—to stimulate the expansion and growth to our economy—to eliminate to the extent possible economic injustice within our own society—and to maintain the level of revenues requested in my predecessor's budget. In each of these endeavors, tax policy has an important role to play and necessary tax changes are herein proposed.

The elimination of certain defects and inequities as proposed below will provide revenue gains to offset the tax reductions offered to stimulate the economy. Thus no net loss of revenue is involved in this set of proposals. I wish to emphasize here that they are a "set"—and that considerations of both revenue and equity, as well as the interrelationship of many of the proposals, urge their consideration as a unit.

I am instructing the Secretary of the Treasury to furnish the Committee on Ways and Means of the House a detailed explanation of these proposals in connection with their legislative consideration.

I. LONG-RANGE TAX REFORM

While it is essential that the Congress receive at this time this administra-

tion's proposals for urgent and obvious tax adjustments needed to fulfill the aims listed above, time has not permitted the comprehensive review necessary for a tax structure which is so complicated and so critically important to so many people. This message is but a first though urgent step along the road to constructive reform.

I am directing the Secretary of the Treasury, building on recent tax studies of the Congress, to undertake the research and preparation of a comprehensive tax reform program to be placed before the next session of the Congress.

Progressing from these studies, particularly those of the Committee on Ways and Means and the Joint Economic Committee, the program should be aimed at providing a broader and more uniform tax base, together with an appropriate rate structure. We can thereby work toward the goal of a higher rate of economic growth, a more equitable tax structure, and a simpler tax law. I know these objectives are shared by—and, at this particular time of year, acutely desired by—the vast majority of the American people.

In meeting the demands of war finance, the individual income tax moved from a selective tax imposed on the wealthy to the means by which the great majority of our citizens participates in paying for well over one-half of our total budget receipts. It is supplemented by the corporation income tax, which provides for another quarter of the total.

This emphasis on income taxation has been a sound development. But so many taxpayers have become so preoccupied with so many tax-saving devices that business decisions are interfered with, and the efficient functioning of the price system is distorted.

Moreover, special provisions have developed into an increasing source of preferential treatment to various groups. Whenever one taxpayer is permitted to pay less, someone else must be asked to pay more. The uniform distribution of the tax burden is thereby disturbed and higher rates are made necessary by the narrowing of the tax base. Of course, some departures from uniformity are needed to promote desirable social or economic objectives of overriding importance which can be achieved most effectively through the tax mechanism. But many of the preferences which have developed do not meet such a test and need to be reevaluated in our tax reform program.

It will be a major aim of our tax reform program to reverse this process by broadening the tax base and reconsidering the rate structure. The result should be a tax system that is more equitable, more efficient, and more conducive to economic growth.

II. TAX INCENTIVE FOR MODERNIZATION AND EXPANSION

The history of our economy has been one of rising productivity, based on improvement in skills, advances in technology, and a growing supply of more efficient tools and equipment. This rise has been reflected in rising wages and standards of living for our workers, as well as a healthy rate of growth for the

economy as a whole. It has also been the foundation of our leadership in world markets, even as we enjoyed the highest wage rates in the world.

Today, as we face serious pressure on our balance-of-payments position, we must give special attention to the modernization of our plant and equipment. Forced to reconstruct after wartime devastation, our friends abroad now possess a modern industrial system helping to make them formidable competitors in world markets. If our own goods are to compete with foreign goods in price and quality, both at home and abroad, we shall need the most efficient plant and equipment.

At the same time, to meet the needs of a growing population and labor force, and to achieve a rising per capita income and employment level, we need a high and rising level of both private and public capital formation. In my preceding messages, I have proposed programs to meet some of our needs for such capital formation in the public area, including investment in intangible capital such as education and research, as well as investment in physical capital such as buildings and highways. I am now proposing additional incentives for the modernization and expansion of private plant and equipment.

Inevitably, capital expansion and modernization—now frequently under the name of “automation”—alter established modes of production. Great benefits result and are distributed widely—but some hardships result as well. This places heavy responsibilities on public policy, not to retard modernization and capital expansion but to promote growth and ameliorate hardships when they do occur—to maintain a high level of demand and employment, so that those who are displaced will be reabsorbed quickly into new positions—and to assist in retraining and finding new jobs for such displaced workers. We are developing, through such measures as the area redevelopment bill and a strengthened Employment Service, as well as assistance to the unemployed, the programs designed to achieve these objectives.

High capital formation can be sustained only by a high and rising level of demand for goods and service. Indeed, the investment incentive itself can contribute materially to achieving the prosperous economy under which this incentive will make its maximum contribution to economic growth. Rather than delaying its adoption until all excess capacity has disappeared and unemployment is low, we should take this step now to strengthen our antirecession program, stimulate employment, and increase our export markets.

Additional expenditures on plant and equipment will immediately create more jobs in the construction, lumber, steel, cement, machinery and other related capital goods industries. The staffing of these new plants—and filling the orders for new export markets—will require additional employees. The additional wages of these workers will help create still more jobs in consumer goods and service industries. The increase in jobs

resulting from a full year's operation of such an incentive is estimated at about half a million.

Specifically, therefore, I recommend enactment of an investment tax incentive in the form of a tax credit of 15 percent of all new plant and equipment investment expenditures in excess of current depreciation allowances; 6 percent of such expenditures below this level but in excess of 50 percent of depreciation allowances; with 10 percent on the first \$5,000 of new investment as a minimum credit.

This credit would be taken as an offset against the firm's tax liability, up to an overall limitation of 30 percent in the reduction of that liability in any one year. It would be separate from and in addition to depreciation of the eligible new investment at cost. It would be available to individually owned businesses as well as corporate enterprises, and apply to eligible investment expenditures made after January 1 of this year. To remain a real incentive and make a maximum contribution to those areas of capital expansion and modernization where it is most needed, and to permit efficient administration, eligible investment expenditures would be limited to expenditures on new plant and equipment, on assets located in the United States, and on assets with a life of 6 years or more. Investments by public utilities other than transportation would be excluded, as would be investment in residential construction including apartments and hotels.

Of the eligible firms, it is expected that many small firms would be able to take advantage of the minimum credit of 10 percent on the first \$5,000 of new investment which is designed to provide a helpful stimulus to the many small businesses in need of modernization. Other small firms subject to a 30-percent tax rate would strive to be eligible for the full 15-percent credit—the equivalent for such firms of a deduction from their gross income for tax purposes of 50 percent of the cost of new investment. Among the remaining firms, it is expected that a majority would be induced to make new investments in modern plant and equipment in excess of their depreciation in order to earn the 15-percent credit. New and growing firms would be particularly benefited. The 6-percent credit for those whose new investment expenditures fall between 50 and 100 percent of their depreciation allowances is designed to afford some substantial incentive to the depressed or hesitant firm which knows it cannot yet achieve the 15-percent credit.

In arriving at this form of tax encouragement to investment, careful consideration was given to other alternatives. If the credit were given across the board to all new investment, a much larger revenue loss would result from those expenditures which would have been undertaken anyway or represent no new level of effort. Our objective is to provide the largest possible inducement to new investment which would not otherwise be undertaken. Thus, the plan recommended above would involve the same revenue loss—approximately \$1.7 bil-

lion—as only a 7-percent credit across the board to all new investment.

The use of current depreciation allowances as the threshold above which the higher rate of credit would apply recommends itself for a number of reasons. Depreciation reflects the average level of investment over the past, but is a less restrictive and more stable test than the use of an average of investment expenditures for a period such as the preceding 5 years. In addition, the depreciation allowances themselves in effect supply tax-free funds for investment up to this level. We now propose a tax credit—which would help to secure funds needed for the additional investment beyond that level.

The proposed credit, in terms of the revenue loss involved, will also be much more effective as an inducement to investment than an outright reduction in the rate of corporation income tax. Its benefits would be distributed more broadly, since the proposed credit will apply to individuals and partnerships as well as corporations. It will also be more effective as a direct incentive to corporate investment, and increase available funds more specifically in those corporations most likely to use them for additional investment. In short, whereas the credit will have the advantage of focusing on the profitability of new investment, much of the revenue loss under a general corporate rate reduction would be diverted into raising the profitability of old investment.

It is true that this advantage of focusing entirely on new investment is shared by the alternative strongly urged by some—a tax change permitting more rapid depreciation of new assets (be it accelerated depreciation or an additional depreciation allowance for the first year). But the proposed investment credit would be superior, in my view, for a number of reasons. In the first place, the determination of the length of an asset's life and proper methods of depreciation have a normal and important function in determining taxable income, wholly apart from any considerations of incentive; and they should not be altered or manipulated for other purposes that would interfere with this function. It may be that on examination some of the existing depreciation rules will be found to be outmoded and inequitable; but that is a question that should be separated from investment incentives. A review of these rules and methods is underway in the Treasury Department as a part of its overall tax reform study to determine whether changes are appropriate and, if so, what form they should take. Adoption of the proposed incentive credit would in no way foreclose later action on these aspects of depreciation.

In the second place, an increase in tax depreciation tends to be recorded in the firm's accounts, thereby raising current costs and acting as a deterrent to price reduction. The proposed investment credit would not share this defect.

Finally, it is clear that the tax credit would be more effective in inducing new investment for the same revenue loss. The entire credit would be reflected immediately in the increased funds

available for investment without increasing the company's future tax liability. A speedup in depreciation only postpones the timing of the tax liability on profits from the investment to a later date—an increase in profitability not comparable to that of an outright tax credit. Yet accelerated depreciation is much more costly in immediate revenues.

For example, on an average investment, a tax credit of 15 percent would bring the same return to the firm as an additional first year depreciation of over 50 percent of the cost of the investment. Yet the immediate revenue loss to the Treasury from such additional depreciation would be twice as much, and would remain considerably higher for many years. The incentive to new investment our economy needs, and which this recommendation would provide at a revenue loss of \$1.7 billion, could be supplied by an initial write off only at an immediate cost of \$3.4 billion.

I believe this investment tax credit will become a useful and continuous part of our tax structure. But it will be a new venture and remain in need of review. Moreover, it may prove desirable for the Congress to modify the credit from time to time, so as to adapt it to the needs of a changing economy. I strongly urge its adoption in this session.

III. TAX TREATMENT OF FOREIGN INCOME

Changing economic conditions at home and abroad, the desire to achieve greater equity in taxation, and the strains which have developed in our balance-of-payments position in the last few years, compel us to examine critically certain features of our tax system which, in conjunction with the tax system of other countries, consistently favor U.S. private investment abroad compared with investment in our own economy.

1. Elimination of tax deferral privileges in developed countries and "tax haven" deferral privileges in all countries. Profits earned abroad by American firms operating through foreign subsidiaries are, under present tax laws, subject to U.S. tax only when they are returned to the parent company in the form of dividends. In some cases, this tax deferral has made possible indefinite postponement of the U.S. tax; and, in those countries where income taxes are lower than in the United States, the ability to defer the payment of U.S. tax by retaining income in the subsidiary companies provides a tax advantage for companies operating through overseas subsidiaries that is not available to companies operating solely in the United States. Many American investors properly made use of this deferral in the conduct of their foreign investment. Though changing conditions now make continuance of the privilege undesirable, such change of policy implies no criticism of the investors who so utilize this privilege.

The undesirability of continuing deferral is underscored where deferral has served as a shelter for tax escape through the unjustifiable use of tax havens such as Switzerland. Recently

more and more enterprises organized abroad by American firms have arranged their corporate structures—aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices which maximize the accumulation of profits in the tax haven—so as to exploit the multiplicity of foreign tax systems and international agreements in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad.

To the extent that these tax havens and other tax deferral privileges result in U.S. firms investing or locating abroad largely for tax reasons, the efficient allocation of international resources is upset, the initial drain on our already adverse balance of payments is never fully compensated, and profits are retained and reinvested abroad which would otherwise be invested in the United States. Certainly since the post-war reconstruction of Europe and Japan has been completed, there are no longer foreign policy reasons for providing tax incentives for foreign investment in the economically advanced countries.

If we are seeking to curb tax havens, if we recognize that the stimulus of tax deferral is no longer needed for investment in the developed countries, and if we are to emphasize investment in this country in order to stimulate our economy and our plant modernization, as well as case our balance-of-payments deficit, we can no longer afford existing tax treatment of foreign income.

I therefore recommend that legislation be adopted which would, after a two-step transitional period, tax each year American corporations on their current share of the undistributed profits realized in that year by subsidiary corporations organized in economically advanced countries. This current taxation would also apply to individual shareholders of closely held corporations in those countries. Since income taxes paid abroad are properly a credit against the U.S. income tax, this would subject the income from such business activities to essentially the same tax rates as business activities conducted in the United States. To permit firms to adjust their operations to this change, I also recommend that this result be achieved in equal steps over a 2-year period, under which only one-half of the profits would be affected during 1962. Where the foreign taxes paid have been close to the U.S. rates, the impact of this change would be small.

This proposal will maintain U.S. investment in the developed countries at the level justified by market forces. American enterprise abroad will continue to compete with foreign firms. With their access to capital markets at home and abroad, their advanced technical know-how, their energy, resourcefulness, and many other advantages, American firms will continue to occupy their rightful place in the markets of the world. While the rate of expansion of some American business operations abroad may be reduced through the withdrawal of tax deferral such reduc-

tion would be consistent with the efficient distribution of capital resources in the world, our balance of payments needs, and fairness to competing firms located in our own country.

At the same time, I recommend that tax deferral be continued for income from investment in the developing economies: The free world has a strong obligation to assist in the development of these economies, and private investment has an important contribution to make. Continued income tax deferral for these areas will be helpful in this respect. In addition, the proposed elimination of income tax deferral on U.S. earnings in industrialized countries should enhance the relative attraction of investment in the less developed countries.

On the other hand, I recommend elimination of the "tax haven" device anywhere in the world, even in the underdeveloped countries, through the elimination of tax deferral privileges for those forms of activities, such as trading, licensing, insurance and others, that typically seek out tax haven methods of operation. There is no valid reason to permit their remaining untaxed regardless of the country in which they are located.

2. Taxation of foreign investment companies: For some years now we have witnessed substantial outflows of capital from the United States into investment companies created abroad whose principal justification lies in the tax benefits which their method of operation produces. I recommend that these tax benefits be removed and that income derived through such foreign investment companies be treated in substantially the same way as income from domestic investment companies.

3. Taxation of American citizens abroad: It is no more justifiable to provide tax exemptions for individuals living in the developed countries than it is to provide tax inducements for capital investment there. Nor should we permit totally unjustified tax benefits to be obtained by those Americans whose choice of residence is dictated primarily by their desire to minimize taxes.

I therefore recommend: that the total tax exemption now accorded the earned income of American citizens residing abroad be completely terminated for those residing in economically advanced countries; that this exemption for earned income be limited to \$20,000 for those residing in the less developed countries; and that the exemption of \$20,000 of earned income now accorded those citizens who stay (but do not reside) abroad for 17 out of 18 months also be completely terminated for those living or traveling in the economically advanced countries.

4. Estate tax on property located abroad: I recommend that the exclusion from the estate tax accorded real property situated abroad be terminated. With the adoption several years ago of the credit for foreign taxes under the estate tax, there is no justification for the continued exemption of such property.

5. Allowance for foreign tax on dividends: Finally, the method by which the credit for foreign income taxes is computed in the case of dividends involves a double allowance for foreign income taxes and should be corrected.

These proposals, along with more detailed and technical changes needed to improve the taxation of foreign income, are expected to reduce substantially our balance-of-payments deficit and to increase revenues by at least \$250 million per year.

IV. CORRECTION OF OTHER STRUCTURAL DEFECTS

I next recommend a number of measures to remove other serious defects in the income tax structure. These changes, while making a beginning toward the comprehensive tax reform program mentioned above, will provide sufficient revenue gains to offset the cost of the investment tax credit and keep the revenue-producing potential of our tax structure intact.

1. Withholding on interest and dividends: Our system of combined withholding and voluntary reporting on wages and salaries under the individual income tax has served us well. Introduced during the war when the income tax was extended to millions of new taxpayers, the wage-withholding system has been one of the most important and successful advances in our tax system in recent times. Initial difficulties were quickly overcome, and the new system helped the taxpayer no less than the tax collector.

It is the more unfortunate, therefore, that the application of the withholding principle has remained incomplete. Withholding does not apply to dividends and interest, with the result that substantial amounts of such income, particularly interest, improperly escape taxation. It is estimated that about \$3 billion of taxable interest and dividends are unreported each year. This is patently unfair to those who must as a result bear a larger share of the tax burden. Recipients of dividends and interest should pay their tax no less than those who receive wage and salary income, and the tax should be paid just as promptly. Large continued avoidance of tax on the part of some has a steadily demoralizing effect on the compliance of others.

This gap in reporting has not been appreciably lessened by educational programs. Nor can it be effectively closed by intensified enforcement measures, except by the expenditure of inordinate amounts of time and money. Withholding on corporate dividends and on investment type interest, such as interest paid on taxable government and corporate securities and savings accounts, is both necessary and practicable.

I therefore recommend the enactment of legislation to provide for a 20-percent withholding rate on corporate dividends and taxable investment type interest, effective January 1, 1962, under a system which would not require the preparation of withholding statements to be sent to recipients. It would thus place a relatively light burden of compliance on the payers of interest and dividends—cer-

tainly less than that placed on payers of wages and salaries—while at the same time largely solving the compliance problem for most of the taxpayers receiving dividends and interest. Steps will also be taken to avoid hardships for recipients who are not subject to tax.

The remaining need for compliance, largely in the high income group subject to a higher tax rate, would be met through the concentration of enforcement devices on taxpayers in these brackets. Introduction of equipment for the automatic processing of information returns would be especially helpful for this purpose and would thus supplement the extension of withholding.

Enactment of this proposal is estimated to increase revenue by \$600 million per year.

2. Repeal of the dividend credit and exclusion: The present law provides for an exclusion from income of the first \$50 of dividends received from domestic corporations, and for a 4-percent credit against tax of such dividend income in excess of \$50. These provisions were enacted in 1954. Proponents argued that they would encourage capital formation through equity investment, and that they would provide a partial offset to the so-called double taxation of dividend income. It is now clear that they serve neither purpose well; and I, therefore, recommend the repeal of both the dividend credit and exclusion.

The dividend credit and exclusion are not an efficient stimulus to capital expansion in the form of plant and equipment. The revenue losses resulting from these provisions are spread over a large volume of outstanding shares rather than being concentrated on new shares; and the stimulating effects of the provisions are thus greatly diluted, resulting in relatively little increases in the supply of equity funds and a relatively slight reduction in the cost of equity financing. In fact, such reduction as does occur is more likely to benefit large corporations with easy access to the capital market, while being of little use to small firms which are not so favorably situated. Insofar as raising the profitability of new investment in plant and equipment is concerned, the tax investment credit proposed above would be far more effective since it is offered to the corporation, where the actual investment decision is made.

The dividend credit and exclusion are equally inadequate as a solution to the so-called problem of double taxation. Whatever may be the merits of the arguments respecting the existence of double taxation, the provisions of the 1954 act clearly do not offer an appropriate remedy. They greatly overcompensate the dividend recipient in the high income bracket, while giving either insufficient or no relief to shareholders with smaller income.

This point deserves emphasis. For viewed simply as a means of tax reduction, the dividend credit is wholly inequitable. The distribution of its benefits is highly favorable to the taxpayers in the upper income groups who receive the major part of dividend income. Only

about 10 percent of dividend income accrues to those with incomes below \$5,000; about 80 percent of it accrues to that 6.5 percent of taxpayers whose incomes exceed \$10,000 a year. Similarly, dividend income is a sharply rising fraction of total income as we move up the income scale. Thus, dividend income is about 1 percent of all income from all sources for those taxpayers with incomes of \$3,000 to \$5,000; but it constitutes more than 25 percent of the income for those with \$100,000 to \$150,000 of income, and about 50 percent for those with incomes over \$1 million.

The role of the dividend credit should not be confused with the broader question of tax rates applicable to high incomes. These high rates deserve re-examination; and this is one of the problems which will be examined in the context of next year's tax reform. But if top bracket rates were to be reduced, the dividend credit is not the way to do it. Rate reductions, if appropriate, should apply no less to those with high incomes from other sources, such as professional and salaried people whose tax position is particularly difficult today.

If the credit is eliminated, the \$50 exclusion should also be discarded for similar reasons. The tax saving from the exclusion is substantially greater for a dividend recipient with a high income than for a recipient with low income. Moreover, on equity grounds, there is no reason for giving tax reduction to that small fraction of low income taxpayers who receive dividends in contrast to those who must live on wages, interest, rents or other forms of income.

The 1954 formula therefore is a dead end and should be rescinded, effective December 31 of this year. The estimated revenue gain is \$450 million per year.

3. Expense accounts: In recent years widespread abuses have developed through the use of the expense account. Too many firms and individuals have devised means of deducting too many personal living expenses as business expenses, thereby charging a large part of their cost to the Federal Government. Indeed, expense account living has become a byword in the American scene.

This is a matter of national concern, affecting not only our public revenues, our sense of fairness, and our respect for the tax system, but our moral and business practices as well. This widespread distortion of our business and social structure is largely a creature of the tax system, and the time has come when our tax laws should cease their encouragement of luxury spending as a charge on the Federal Treasury. The slogan—"It's deductible"—should pass from our scene.

Tighter enforcement of present legislation will not suffice. Even though in some instances entertainment and related expenses have an association with the needs of business, they nevertheless confer substantial tax-free personal benefits to the recipients. In other cases, deductions are obtained by disguising personal expenses as business outlays. But under present law, it is extremely difficult to separate out and disallow

such pseudobusiness expenditures. New legislation is needed to deal with the problem.

I therefore recommend that the cost of such business entertainment and the maintenance of entertainment facilities (such as yachts and hunting lodges) be disallowed in full as a tax deduction and that restrictions be imposed on the deductibility of business gifts, expenses of business trips combined with vacations, and excessive personal living expenses incurred on business travel away from home.

I feel confident that these measures will be welcomed by the American people. I am also confident that business firms, now forced to emulate the expense account favors of their competitors, however unsound or uneconomical such practices may be, will welcome the removal of this pressure. These measures will strengthen both our tax structure and the moral fiber of our society. These provisions should be effective as of January 1, 1962 and are estimated to increase Treasury receipts by at least \$250 million per year.

4. Capital gains on sale of depreciable business property: Another flaw which should be corrected at this time relates to the taxation of gains on the sale of depreciable business property. Such gains are now taxed at the preferential rate applicable to capital gains, even though they represent ordinary income.

This situation arises because the statutory rate of depreciation may not coincide with the actual decline in the value of the asset. While the taxpayer holds the property, depreciation is taken as a deduction from ordinary income. Upon its resale, where the amount of depreciation allowable exceeds the decline in the actual value of the asset so that a gain occurs, this gain under present law is taxed at the preferential capital gains rate. The advantages resulting from this practice have been increased by the liberalization of depreciation rates.

Our capital gains concept should not encompass this kind of income. This inequity should be eliminated, and especially so in view of the proposed investment credit. We should not encourage through tax incentives the further acquisition of such property as long as this loophole remains.

I therefore recommend that capital gains treatment be withdrawn from gains on the disposition of depreciable property, both personal and real property, to the extent that depreciation has been deducted for such property by the seller in previous years, permitting only the excess of the sales price over the original cost to be treated as a capital gain. The remainder should be treated as ordinary income. This reform should immediately become effective as to all sales taking place after the date of enactment. It is estimated to raise revenue by \$200 million annually.

5. Cooperatives and financial institutions: Another area of the tax laws which calls for attention is the treatment of cooperatives, private lending institutions, and fire and casualty insurance companies.

Contrary to the intention of Congress, substantial income from certain cooperative enterprises, reflecting business operations, is not being taxed either to the cooperative organization itself or its members. This situation must be corrected in a manner that is fair and just to both the cooperatives and competing businesses.

The present inequity has resulted from court decisions which held patronage refunds in certain forms to be nontaxable. I recommend that the law be clarified so that all earnings are taxable to either the cooperatives or to their patrons, assessing the patron on the earnings that are allocated to him as patronage dividends or refunds in scrip or cash. The withholding principle recommended above should also be applied to patronage dividends or refunds so that the average patron receiving scrip will, in effect, be given the cash to pay his tax on his patronage dividend or refund. The cooperatives should not be penalized by the assessment of a patronage tax upon dividends or refunds taxable to the patron but left in the business as a substitute for the sale of securities to obtain additional equity capital. The exemption for rural electric cooperatives and credit unions should be continued.

The tax provisions applicable to fire and casualty insurance companies, originally adopted in 1942, need to be reviewed in the light of current conditions. Many of these companies, organized on the mutual or reciprocal basis are now taxed under a special formula which does not take account of their underwritings gains and thus results in an inequitable distribution of the tax burden among various types of companies. Consideration should be given to taxing mutual or reciprocal companies on a basis similar to stock companies, following the pattern of similar treatment of stock and mutual enterprise in the life insurance field.

Some of the most important types of private savings and lending institutions in the country are accorded tax deductible reserve provisions which substantially reduce or eliminate their Federal income tax liability. These provisions should be reviewed with the aim of assuring nondiscriminatory treatment.

Remedial legislation in these fields would enlarge the revenues and contribute to a fair and sound tax structure.

V. TAX ADMINISTRATION

One of the major characteristics of our tax system, and one in which we can take a great deal of pride, is that it operates primarily through individual self-assessment. The integrity of such a system depends upon the continued willingness of the people honestly and accurately to discharge this annual price of citizenship. To the extent that some people are dishonest or careless in their dealings with the Government, the majority is forced to carry a heavier tax burden.

For voluntary self-assessment to be both meaningful and productive of revenues, the citizens must not only have confidence in the fairness of the tax laws, but also in their uniform and vigorous

enforcement of these laws. If noncompliance by the few continues unchecked, the confidence of the many in our self-assessment system will be shaken and one of the cornerstones of our Government weakened.

I have in this message already recommended the application of withholding to dividends and interest and revisions to halt the abuses of expense accounts. These measures will improve taxpayer compliance and raise the regard of taxpayers for the fairness of our system. In addition, I propose three further measures to improve the tax enforcement machinery.

1. Taxpayer account numbers: The Internal Revenue Service has begun the installation of automatic data processing equipment to improve administration of the growing job of tax collection and enforcement. A system of identifying taxpayer account numbers, which would make possible the bringing together of all tax data for any one particular taxpayer, is an essential part of such an improved collection and enforcement program.

For this purpose, social security numbers would be used by taxpayers already having them. The small minority currently without such numbers would be assigned numbers which these persons could later use as well for social security purposes if needed. The numbers would be entered on tax returns, information returns, and related documents.

I recommend that legislation be enacted to authorize the use of taxpayer account numbers beginning January 1, 1962, to identify taxpayer accounts throughout the processing and record-keeping operations of the Internal Revenue Service.

2. Increased audit coverage: The examination of tax returns is the essence of the enforcement process. The number of examining personnel of the Internal Revenue Service, however, has been consistently inadequate to cope with the audit workload. Consequently, it has been unable to audit carefully many of the returns which should be so examined. Anticipated growth in our population will, of course, increase this enforcement problem.

Related to broadened tax audit is the criminal enforcement program of the Revenue Service. Here, the guiding principle is the creation of a deterrent to tax evasion and to maintain or, if possible, increase voluntary compliance with all taxing statutes. This means placing an appropriate degree of investigative emphasis on all types of tax violations, in all geographical areas, and identifying violations of substance in all income brackets regardless of occupation, business, or profession.

Within this framework of a balanced enforcement effort, the Service is placing special investigative emphasis on returns filed by persons receiving income from illegal sources. I have directed all Federal law enforcement agencies to cooperate fully with the Attorney General in a drive against organized crime, and to utilize their resources to the maximum extent in conducting investigations of individuals engaged in criminal activity on a major scale.

With the foregoing in mind, I have directed the Secretary of the Treasury to provide through the Internal Revenue Service a maximum effort in this field.

To fulfill these requirements for improved audits, enforcement and anti-crime investigation, it is essential that the Service be provided additional resources which will pay their own cost many times over. In furthering the Service's long-range plans, the prior administration asked additional appropriations of \$27.4 million to hire about 3,500 additional personnel during fiscal 1962, including provisions for the necessary increases in space and modern equipment vital to the efficient operation of the Service. To meet the commitments described above, this administration reviewed these proposals and recommended that they be increased by another \$7 million and 765 additional personnel to expedite the expansion and criminal enforcement programs. The pending alternative of only 1,995 additional personnel, or less than one-half of the number requested, this administration would constitute little more than the additional employees needed each year during the 1960's just to keep up with the estimated growth in number and complexity of returns filed. Thus I must again strongly urge the Congress to give its full support to my original request. These increases will safeguard the long-term adequacy of the Nation's traditional voluntary compliance system and, at the same time, return the added appropriations several times over in added revenue.

3. Inventory reporting: It is increasingly apparent that the manipulation of inventories has become a frequent method of avoiding taxes. Current laws and regulations generally permit the use of inventory methods which are acceptable in recognized accounting practice. Deviations from these methods, which are not always easy to detect during examination of tax returns, can often lead to complete nonpayment of taxes until the inventories are liquidated; and, for some taxpayers, this represents permanent tax reduction. The understating of the valuation of inventories is the device most frequently used.

I have directed the Internal Revenue Service to give increasing attention to this area of tax avoidance, through a stepped-up emphasis on both the verification of the amounts reported as inventories and an examination of methods used in arriving at their reported valuation.

VI. TAX RATE EXTENSION

As recommended by my predecessor, it is again necessary that Congress enact an extension of present corporation income and excise tax rates otherwise scheduled for reduction or termination on July 1, 1961. Such extension has been adopted by the Congress on a number of previous occasions, and our present revenue requirements make such extension absolutely necessary again this year.

In the absence of such legislation, the corporate tax rate would be decreased 5 percentage points, from 52 percent to 47 percent, excise tax rates on distilled

spirits, beer, wines, cigarettes, passenger automobiles, automobile parts and accessories, and the transportation of persons would also decline; and the excise tax on general telephone service would expire. We cannot afford the loss of these revenues at this time.

VII. AVIATION FUEL

The last item on the agenda relates to aviation fuel. The two previous administrations have urged that civil aviation, a mature and growing industry, be required to pay a fair share of the costs of operating and improving the Federal airways system. The rapidly mounting costs of these essential services to air transportation makes the imposition of user charges more imperative now than ever before. The most efficient method for recovering a portion of these costs equitably from the airway users is through a tax on aviation fuel. Present law provides for a net tax of 2 cents a gallon on aviation gasoline but no tax on jet fuel. The freedom from tax of jet fuel is inequitable and is resulting in substantial revenue losses due to the transition to jet power and the resulting decline in gasoline consumption.

My predecessor recommended a flat 4½-cent tax for both aviation gasoline and jet fuels. Such a request, however, appears to be unrealistic in view of the current financial condition of the airline industry.

Therefore I recommend: Extending the present net 2-cent rate on aviation gasoline to jet fuels; holding this uniform rate covering both types of fuel at the 2-cent level for fiscal 1962; and providing for annual increments in this rate of one-half cent after fiscal year 1962 until the portion of the cost of the airways properly allocable to civil aviation is substantially recovered by this tax.

The immediate increase in revenue from this proposal is modest in comparison with anticipated airways costs; and the annual gradation of further increases is intended to moderate the impact of the tax on the air carrier industry. Should future economic or other developments warrant, a more rapid increase in the fuel tax will be recommended. The decline from the revenues estimated by my predecessor is not large, and will be met by the reforms previously proposed. I repeat my earlier recommendation that, consistent with the user charge principle, revenues from the aviation fuels tax be retained in the general fund rather than diverted to the highway trust fund.

CONCLUSION

The legislation recommended in this message offers a first step toward the broader objective of tax reform. The immediate need is for encouraging economic growth through modernization and capital expansion, and to remove tax preferences for foreign investment which are no longer needed and which impair our balance-of-payments position. A beginning is made also toward removing some of the more glaring defects in the tax structure. The revenue gain in these proposals will offset the revenue cost of the investment credit. Finally, certain rate extensions

are needed to maintain the revenue potential of our fiscal system.

These items need to be done now; but they are a first step only. They will be followed next year by a second set of proposals, aimed at thorough income tax reform. Their purpose will be to broaden and unify the income tax base, and to review the entire rate structure in the light of these revisions. Let us join in solving these immediate problems in the coming months, and then join in further action to strengthen the foundations of our revenue system.

JOHN F. KENNEDY.

THE WHITE HOUSE, April 20, 1961.

AMENDMENT OF NATIONAL AERONAUTICS AND SPACE ACT OF 1958

Mr. MANSFIELD. Mr. President, I move that the Senate proceed to the consideration of Calendar No. 147, House bill 6169.

The motion was agreed to; and the Senate proceeded to consider the bill (H.R. 6169) to amend section 201 of the National Aeronautics and Space Act of 1958.

Mr. KERR. Mr. President, the pending measure is an administration proposal to make certain changes in section 201 of the National Aeronautics and Space Act of 1958, which established the National Aeronautics and Space Council to advise the President on space matters. The Council is composed of the President, the Secretary of State, the Secretary of Defense, the Administrator of NASA, and the Chairman of the Atomic Energy Commission; and authority is reposed in the President to appoint, by and with the advice and consent of the Senate, a member from the Federal departments and agencies of the Government and three civilian members.

In his letter of transmittal, accompanying the proposal, the President stated that he contemplated making the Council an active and useful instrumentality. He further stated that he desired to place the Council under the chairmanship of the Vice President. The present measure would amend the law so as to replace the President by the Vice President, as Chairman of the Council. It would also repeal the existing authority of the President to appoint a member from the Federal departments and agencies of the Government and three members from civilian life, and would make certain conforming changes. There would be no changes which would affect the present concept of the Council, which was established as an advisory body to the President.

The Committee on Aeronautical and Space Sciences was unanimous in its action in reporting the bill without amendment; and I request that the bill be passed by the Senate.

Mr. BRIDGES. Mr. President, I sat in the committee during the hearings on the bill, and I have been familiar with space legislation since it was first introduced and passed in this body.

The enactment of this bill will result in a decrease in the number of people on the Space Council by eliminating the four public members, so-called. It also

substitutes as the Chairman of the Council, the Vice President of the United States instead of the President of the United States. With the delegation of the chairmanship of the Council to the Vice President, the President continues nevertheless to be the final determining authority in aeronautical and space activities.

Nothing in this bill lessens his responsibilities in this field.

There is one point about this legislation, into which we inquired rather carefully at the hearing. That was the concern of some of us that the military of this country, on whose shoulders rests the responsibility for the security of our Nation, not be lowered or in any way squeezed out of the Space Council or the consultations of the Space Council. They are represented on the Council by the distinguished Secretary of Defense, Mr. McNamara, whom I consider a very able man.

In previous great projects in which this country has engaged, such as the Manhattan project, which involved the building of the atomic bomb, we had a small group consisting of four Members of the House and four Members of the Senate, who were kept informed on the project and guided the appropriations through Congress secretly. The project had a most effective advisory council board composed of Dr. Bush, Dr. Conant, Admiral Purnell, and General Styer. Lieutenant General Groves of course was the head of the Manhattan project. It was probably one of the best run, best operated, most successful, and most secret operations in which this country or any other country ever engaged. Likewise, in the old NACA organization we also had military representation, on all levels.

I wish to know, and I think many other persons want to know, and the record of the hearing developed this matter, that the Council will work closely with the military, whether it be the Joint Chiefs of Staff, the Chief of Staff of the Air Force, or the head of the Air Research and Development Command in the Air Force, headed by General Shriever. That is important. In the reporting and passage of the bill, I have a concern, which I believe is shared by some of my colleagues, about which I would like to ask the distinguished and able chairman of the committee, with whom it is such a pleasure to work. Does he believe, and is it understood, that the military, on whose shoulders the defense and security of this country is placed, will be called in and will work closely with the Space Council, and its views will always receive consideration, and it will have an open door to the Council?

Mr. KERR. Mr. President, in response to the question of the distinguished and able Senator from New Hampshire, it is my opinion that the military will always have access to the ears of those on the Space Council, as they have the ears of the members of the committee which reported the bill, and of which the distinguished Senator from New Hampshire is the ranking Republican member. Certainly, the military's part of the space program is very,

very important and significant. I do not believe there is anything in the legislation or in the program which would in any way impair the position of the military or prevent its position from being recognized and felt just as it would be without this legislation.

Mr. BRIDGES. I thank the Senator, and in view of that assurance concur in the passage of the bill.

Mr. KERR. I thank the Senator.

Mr. HOLLAND. Mr. President, will the Senator yield?

Mr. KERR. I yield to the Senator from Florida.

Mr. HOLLAND. First, I compliment my distinguished friend, the chairman of the committee, for the careful way in which he has handled the bill. I was not able to remain throughout the hearings, but I was pleased at the care displayed in the questioning of the principal witness, both by the distinguished chairman and the ranking minority member.

It seems to me we are not dealing with this matter impersonally, and we cannot do so, because we all know that the Vice President, who will be made the Chairman of the Council, and who, of course, will be, in administration matters, closer to the President than any other person, is also moving from the chairmanship of this very committee to the post as head of the Council. We also know, in relation to the question raised by the Senator from New Hampshire, and I think properly raised, that the Vice President served, while he was a Member of the Senate, not only as a member of the Armed Services Committee, but as chairman of the subcommittee on military preparedness. So it seems to me a very fortuitous set of circumstances which would make, under the bill, chairman of the modified council—somewhat modified from the original council—the very person who is in the best position to serve in that post, and to bring together the views of the Senate, the administration, and the armed services.

I think the bill is an exceptionally good one, and a fine adaptation of the old establishment to a new set of circumstances which we have under the national administration.

I congratulate the distinguished Senator from Oklahoma.

Mr. KERR. I thank the Senator from Florida, who is a distinguished and able member of the committee, both for his participation in committee and for his remarks on the floor.

Mr. SPARKMAN. Mr. President—
The PRESIDING OFFICER (Mr. BURDICK in the chair). The Senator from Alabama.

Mr. SPARKMAN. Mr. President, I am willing to yield the floor in order that the bill may be passed, with the unanimous understanding that I will be recognized immediately thereafter.

The PRESIDING OFFICER. Without objection, it is so ordered.

The bill is open to amendment. If there be no amendment to be proposed, the question is on the third reading and passage of the bill.

tribute projects widely among the several States, so far as feasible and proper, in order that actual experience with the program may be had in as many States and areas and under as many different circumstances as possible.

GEOGRAPHICAL BOUNDARIES OF REDEVELOPMENT AREAS

The Senate bill provided that areas designated as redevelopment areas for assistance under the new program could include "one or more States, one or more counties, or one or more municipalities, or a part of a county or municipality." This provision was eliminated by the House amendment. The conferees agreed to follow the House amendment in this respect.

It is the intent of the conferees for both Houses that in designating industrial areas as redevelopment areas for assistance under the new program, the Secretary should have broad discretion. The data on eligible areas supplied to the Congress by the Labor Department during the hearings were based on existing labor market areas and the Secretary should certainly take this information into account in determining geographical boundaries of redevelopment areas.

At the same time, the conferees recognize that standard labor market area boundary lines may not be appropriate to the purposes of this act because smaller areas may be more realistic. The bill, therefore, does not necessarily require that the labor market area boundary lines be followed. It is contemplated instead that the Secretary of Commerce may establish appropriate new boundaries for redevelopment areas under the bill.

It is not, however, the intention of the conferees to authorize designation of part of a municipality as a redevelopment area in any case, but with that exception it is recognized that designation of redevelopment areas will not necessarily follow political boundary lines.

LOANS FOR MACHINERY AND EQUIPMENT

Section 6 of the Senate bill authorized loans for machinery and equipment for plants "in cases of demonstrated need." The corresponding provision of the House amendment authorized such loans "in exceptional cases." The conference substitute retains the language of the Senate bill.

APPROVAL OF APPLICANTS BY STATE

Section 6(b)(2) of the Senate bill provided for approval of applicants for section 6 loans (plant loans) by the State or political subdivision concerned, through an agency directly concerned with problems of economic development in the State or political subdivision. The corresponding provision in the House amendment required approval by the State; it did not authorize loans to applicants on the basis of approval by a political subdivision. The conference substitute conforms to the Senate bill.

INVESTMENT BY INDIAN TRIBES IN SECTION 6 PROJECTS

The House amendment provided (in sec. 6(b)(9)(B)) that a Federal loan could be made under section 6 only if at least 10 percent of the cost were invested by the State or political subdivision or by a nongovernmental community or area organization. The Senate bill contained the same requirement except that it added "Indian tribes" to the list of organizations which might make the required 10 percent investment. The conference substitute conforms to the Senate bill.

COMPETITION WITH PRIVATELY OWNED UTILITIES

The Senate bill prohibited assistance under section 7 or 8 for public facilities which would compete with existing privately owned public utilities, unless the State regulatory body found a need for such service which the

existing public utility was unable to meet now "or through an expansion which it agrees to undertake." The House amendment substituted "is prepared" for "agrees." The conference substitute retains the provision of the Senate bill.

PUBLIC FACILITY GRANTS

The Senate bill permitted grants under section 8 covering the entire difference between the cost of the project and the amount obtainable from other sources. The House amendment limited the grants under section 8 to 65 percent of the difference between the cost of the project and the amount obtainable from loans and other Federal grant programs. The conference substitute follows the language of the Senate bill.

FINANCING OF LOAN PROGRAMS

The House amendment authorized appropriations to provide funds for loans under sections 6 and 7 of the bill. The Senate bill authorized the Secretary of the Treasury to obtain such funds through public debt transactions under the Second Liberty Bond Act. The conference substitute follows the provisions of the Senate bill in this respect but adopts the House provisions with respect to (1) the establishment of one area redevelopment fund (rather than three revolving funds as in the Senate bill), and (2) the requirement that the fund contribute to the civil service retirement and disability fund with respect to employees performing activities under sections 6 and 7.

URBAN PLANNING GRANTS

Both the House and Senate versions of the bill contained identical language making it possible for urban planning grants to be made directly to areas designated under section 5(a) of the Area Redevelopment Act as redevelopment areas. It is our understanding that this provision is not intended to bypass State planning agencies. Rather it is our understanding that the intention is to provide an alternative route for extending this planning assistance where deemed necessary or advisable but that existing State agencies will continue to be consulted and utilized wherever practicable.

The Senate bill also authorizes urban planning grants of up to 75 percent of cost for such areas. This provision was not included in the House amendment which kept the 50-percent limit applicable to urban planning grants under existing law. The House recedes. Under the substitute agreed to in conference, 75-percent grants could be made for such areas either directly or through State planning agencies.

REPORTS TO CONGRESS

The conference substitute follows the language of the House amendment as to reports to the Congress, and does not include all of the specific provisions of the Senate bill with respect to matters to be included in such reports. The conferees on the part of both Houses intend, however, that such reports shall give full and complete information concerning the operation of the program, and shall include the following items in addition to those specified in the act: (1) The total number of unemployed persons in redevelopment areas; (2) the total principal amount of loans outstanding under the act, the aggregate expenditures incurred by the Government in providing grants and other forms of assistance under the act, and the administrative expenses incurred by the Government in providing assistance under the act; (3) the number of applications for assistance under the act which are pending and the total amount of assistance requested in such applications; (4) the number of industrial or commercial enterprises which have commenced or expanded opera-

tions in redevelopment areas as a result of assistance under the act, the total asset value of such enterprises, and a description of each such enterprise in terms of whether it is an expanding enterprise already located in a redevelopment area, a wholly new enterprise, an enterprise which has moved from another area, or a branch of an existing enterprise located elsewhere; and (5) the total number of jobs directly created in each redevelopment area as a result of assistance extended under the act, and the Secretary's estimate of the increase in employment in each such area indirectly resulting from such assistance.

USE OF OTHER AGENCIES BY DEPARTMENT OF COMMERCE

The conference substitute follows the language of the House bill with respect to delegation of authority by the Secretary of Commerce to other Federal agencies. The Secretary of Commerce has testified before the committees of both the House and the Senate that he will delegate to the Department of Agriculture major responsibility for assistance to be rendered in rural redevelopment areas, as designated under section 5(b) of the act, and the Secretary of Agriculture has testified to his willingness to accept such responsibility. It is the understanding of the conferees that the Department of Agriculture has services and facilities available of requisite competence and experience for effectively carrying out such delegation. It is, therefore, the expectation of the conferees that this delegation to the Department of Agriculture will be made promptly upon enactment of the bill.

STUDY BY THE SECRETARY OF COMMERCE

The House amendment (sec. 27) directed the Secretary of Commerce, when the Department of Defense proposes to deactivate a permanent military installation or major unit thereof in an area where the employment rate is 6 percent or more, to make a study to determine the economic effects of such deactivation when requested to do so by the Governor of the State where the installation is located. It provided that the Secretary's findings would be transmitted to the Secretary of Defense and the Congress. The House recedes and the provision is omitted from the substitute agreed to in conference.

RESEARCH ON CAUSES OF UNEMPLOYMENT

The House amendment (sec. 28) directed the Secretary of Commerce to conduct a continuing program of study and research to assist in determining the causes of unemployment, underemployment, underdevelopment, and chronic depression in the various areas of the Nation and in the Nation as a whole, and to assist in developing programs to solve these problems. The Senate bill contained no corresponding provision. The substitute agreed to in conference retains this provision with two amendments. One amendment provides that the study shall be made in cooperation with other agencies having similar functions. The second amendment eliminates the phrase "and in the Nation as a whole."

TERMINATION OF PROGRAM

The conference substitute contains a provision that was in the Senate bill but not in the House amendment, terminating the program on June 30, 1965. It also provides for liquidation of the program after that date by the Secretary of the Treasury. The carrying out of contracts, commitments, and other obligations theretofore entered into under the program would not be affected by its termination.

BRENT SPENCE,
WRIGHT PATMAN,
ALBERT RAINS,
ABRAHAM J. MULTER,

Managers on the Part of the House.

INTER-AMERICAN SOCIAL AND ECONOMIC COOPERATION PROGRAM AND THE CHILEAN RECONSTRUCTION AND REHABILITATION PROGRAM

Mr. PASSMAN, from the Committee on Appropriations, reported the bill (H.R. 6518) making appropriations for the inter-American social and economic cooperation program and the Chilean reconstruction and rehabilitation program for the fiscal year ending June 30, 1961, and for other purposes (Rept. No. 254), which was read a first and second time, and, with the accompanying papers, referred to the Committee of the Whole House on the State of the Union and ordered to be printed.

Mr. WILSON of Indiana reserved all points of order on the bill.

COMMISSION APPOINTMENTS

The SPEAKER. Pursuant to the provisions of 16 United States Code 513, the Chair appoints as members of the National Forest Reservation Commission the following Members on the part of the House: Mr. COLMER and Mr. WESTLAND.

Pursuant to the provisions of section 1, Public Law 742, 83d Congress, the Chair appoints as members of the National Monument Commission the following Members on the part of the House: Mr. JONES, Mr. ULLMAN, Mrs. ST. GEORGE, and Mr. NYGAARD.

Pursuant to the provisions of section 3, Public Law 85-470, the Chair appoints as members of the National Outdoor Recreation Resources Review Commission the following Members on the part of the House: Mrs. FROST, Mr. RIVERS of Alaska, Mr. SAYLOR, and Mr. KYL.

Pursuant to the provisions of section 1, Public Resolution 32, 73d Congress, the Chair appoints as members of the U.S. Territorial Expansion Memorial Commission the following Members on the part of the House: Mr. KARSTEN, Mr. HAYS, and Mr. CUNNINGHAM.

Pursuant to the provisions of section 105(c), Public Law 624, 84th Congress, the Chair appoints as members of the Committee on the House Recording Studio the following Members of the House: Mr. GARY, Mr. O'BRIEN of New York, and Mr. Bow.

Pursuant to the provisions of section 6, Public Law 754, 81st Congress, the Chair appoints as members of the Federal Records Council the following Members on the part of the House: Mr. STAGGERS and Mr. GOODELL.

THIRTEENTH BIRTHDAY OF STATE OF ISRAEL

(Mr. TOLL asked and was given permission to extend his remarks at this point in the RECORD.)

Mr. TOLL. Mr. Speaker, today is the 13th birthday of the State of Israel. Traditionally in Jewish chronology the 13th birthday is the day marking the growth into adulthood. The State of Israel has attained maturity not only in years. The population has increased from 790,000 to 2,128,000. Industrial production is now over a billion dollars. Exports are over a quarter of a billion, and imports over a half a billion. Agri-

cultural production is \$183 million. In 1960 a fleet of 53 ships handled 445,000 tons of cargo. Elementary school education to 600,000 students, and Israel has now over 22,000 teachers.

In the House today a distinguished rabbi of my district, Alex J. Goldman, the spiritual leader of the West Oak Lane Jewish Community Center, has delivered the opening prayer calling attention to this anniversary. The Philadelphia Zionist Council, in conjunction with the city of Philadelphia, has scheduled a celebration luncheon at the Warwick Hotel on Sunday, April 23, in honor of His Excellency, Michael S. Comay, Ambassador of Israel to the United Nations. Immediately following the luncheon a public celebration will be held at Independence Hall. The members of the Philadelphia congressional delegation will participate in this observance, and the Lieutenant Governor of the Commonwealth of Pennsylvania, the Honorable John Morgan Davis, will join with the Ambassador in commemorating Israel's bar mitzvah anniversary.

The chairman of the Philadelphia Zionist Council is the distinguished spiritual leader of the Germantown Jewish Community Center, Rabbi Elias Charry of my district. The chairman of the Independence Hall celebration is an outstanding leader of the Philadelphia bar, Herbert S. Levin, Esq.

I hope that at the next celebration of Israel's birthday I will be able to include a statement that Israel has been able to establish peace with her neighbors.

FEDERAL TAX SYSTEM—MESSAGE FROM THE PRESIDENT OF THE UNITED STATES (H. DOC. NO. 140)

The SPEAKER laid before the House the following message from the President of the United States, which was read, referred to the Committee on Ways and Means, and ordered to be printed:

To the Congress of the United States:

A strong and sound Federal tax system is essential to America's future. Without such a system, we cannot maintain our defenses and give leadership to the free world. Without such a system, we cannot render the public services necessary for enriching the lives of our people and furthering the growth of our economy.

The tax system must be adequate to meet our public needs. It must meet them fairly, calling on each of us to contribute his proper share to the cost of Government. It must encourage efficient use of our resources. It must promote economic stability and stimulate economic growth. Economic expansion in turn creates a growing tax base, thus increasing revenue and thereby enabling us to meet more readily our public needs, as well as our needs as private individuals.

This message recognizes the basic soundness of our tax structure. But it also recognizes the changing needs and standards of our economic and international position, and the constructive re-

form needs to keep our tax system up to date and to maintain its equity. Previous messages have emphasized the need for prompt congressional and executive action to alleviate the deficit in our international balance of payments—to increase the modernization, productivity and competitive status of American industry—to stimulate the expansion and growth of our economy—to eliminate to the extent possible economic injustice within our own society—and to maintain the level of revenues requested in my predecessor's budget. In each of these endeavors, tax policy has an important role to play and necessary tax changes are herein proposed.

The elimination of certain defects and inequities as proposed below will provide revenue gains to offset the tax reductions offered to stimulate the economy. Thus no net loss of revenue is involved in this set of proposals. I wish to emphasize here that they are a "set"—and that considerations of both revenue and equity, as well as the interrelationship of many of the proposals, urge their consideration as a unit.

I am instructing the Secretary of the Treasury to furnish the Committee on Ways and Means of the House a detailed explanation of these proposals in connection with their legislative consideration.

I. LONG-RANGE TAX REFORM

While it is essential that the Congress receive at this time this administration's proposals for urgent and obvious tax adjustments needed to fulfill the aims listed above, time has not permitted the comprehensive review necessary for a tax structure which is so complicated and so critically important to so many people. This message is but a first though urgent step along the road to constructive reform.

I am directing the Secretary of the Treasury, building on recent tax studies of the Congress, to undertake the research and preparation of a comprehensive tax reform program to be placed before the next session of the Congress.

Progressing from these studies, particularly those of the Committee on Ways and Means and the Joint Economic Committee, the program should be aimed at providing a broader and more uniform tax base, together with an appropriate rate structure. We can thereby work toward the goal of a higher rate of economic growth, a more equitable tax structure, and a simpler tax law. I know these objectives are shared by—and, at this particular time of year, acutely desired by—the vast majority of the American people.

In meeting the demands of war finance, the individual income tax moved from a selective tax imposed on the wealthy to the means by which the great majority of our citizens participates in paying for well over one-half of our total budget receipts. It is supplemented by the corporation income tax, which provides for another quarter of the total.

This emphasis on income taxation has been a sound development. But so many taxpayers have become so preoccupied with so many tax-saving devices that business decisions are interfered with,

and the efficient functioning of the price system is distorted.

Moreover, special provisions have developed into an increasing source of preferential treatment to various groups. Whenever one taxpayer is permitted to pay less, someone else must be asked to pay more. The uniform distribution of the tax burden is thereby disturbed and higher rates are made necessary by the narrowing of the tax base. Of course, some departures from uniformity are needed to promote desirable social or economic objectives of overriding importance which can be achieved most effectively through the tax mechanism. But many of the preferences which have developed do not meet such a test and need to be reevaluated in our tax reform program.

It will be a major aim of our tax reform program to reverse this process by broadening the tax base and reconsidering the rate structure. The result should be a tax system that is more equitable, more efficient and more conducive to economic growth.

II. TAX INCENTIVE FOR MODERNIZATION AND EXPANSION

The history of our economy has been one of rising productivity, based on improvement in skills, advances in technology, and a growing supply of more efficient tools and equipment. This rise has been reflected in rising wages and standards of living for our workers, as well as a healthy rate of growth for the economy as a whole. It has also been the foundation of our leadership in world markets, even as we enjoyed the highest wage rates in the world.

Today, as we face serious pressure on our balance-of-payments position, we must give special attention to the modernization of our plant and equipment. Forced to reconstruct after wartime devastation, our friends abroad now possess a modern industrial system helping to make them formidable competitors in world markets. If our own goods are to compete with foreign goods in price and quality, both at home and abroad, we shall need the most efficient plant and equipment.

At the same time, to meet the needs of a growing population and labor force, and to achieve a rising per capita income and employment level, we need a high and rising level of both private and public capital formation. In my preceding messages, I have proposed programs to meet some of our needs for such capital formation in the public area, including investment in intangible capital such as education and research, as well as investment in physical capital such as buildings and highways. I am now proposing additional incentives for the modernization and expansion of private plant and equipment.

Inevitably, capital expansion and modernization—now frequently under the name of automation—alter established modes of production. Great benefits result and are distributed widely—but some hardships result as well. This places heavy responsibilities on public policy, not to retard modernization and

capital expansion but to promote growth and ameliorate hardships when they do occur—to maintain a high level of demand and employment, so that those who are displaced will be reabsorbed quickly into new positions—and to assist in retraining and finding new jobs for such displaced workers. We are developing, through such measures as the area redevelopment bill and a strengthened Employment Service, as well as assistance to the unemployed, the programs designed to achieve these objectives.

High capital formation can be sustained only by a high and rising level of demand for goods and service. Indeed, the investment incentive itself can contribute materially to achieving the prosperous economy under which this incentive will make its maximum contribution to economic growth. Rather than delaying its adoption until all excess capacity has disappeared and unemployment is low, we should take this step now to strengthen our antirecession program, stimulate employment and increase our export markets.

Additional expenditures on plant and equipment will immediately create more jobs in the construction, lumber, steel, cement, machinery, and other related capital goods industries. The staffing of these new plants—and filling the orders for new export markets—will require additional employees. The additional wages of these workers will help create still more jobs in consumer goods and service industries. The increase in jobs resulting from a full year's operation of such an incentive is estimated at about half a million.

Specifically, therefore, I recommend enactment of an investment tax incentive in the form of a tax credit of 15 percent of all new plant and equipment investment expenditures in excess of current depreciation allowances; 6 percent of such expenditures below this level but in excess of 50 percent of depreciation allowances; with 10 percent on the first \$5,000 of new investment as a minimum credit.

This credit would be taken as an offset against the firm's tax liability, up to an overall limitation of 30 percent in the reduction of that liability in any one year. It would be separate from and in addition to depreciation of the eligible new investment at cost. It would be available to individually owned businesses as well as corporate enterprises, and apply to eligible investment expenditures made after January 1 of this year. To remain a real incentive and make a maximum contribution to those areas of capital expansion and modernization where it is most needed, and to permit efficient administration, eligible investment expenditures would be limited to expenditures on new plant and equipment, on assets located in the United States, and on assets with a life of 6 years or more. Investments by public utilities other than transportation would be excluded, as would be investment in residential construction including apartments and hotels.

Of the eligible firms, it is expected that many small firms would be able to

take advantage of the minimum credit of 10 percent on the first \$5,000 of new investment which is designed to provide a helpful stimulus to the many small businesses in need of modernization. Other small firms, subject to a 30-percent tax rate, would strive to be eligible for the full 15-percent credit—the equivalent for such firms of a deduction from their gross income for tax purposes of 50 percent of the cost of new investment. Among the remaining firms, it is expected that a majority would be induced to make new investments in modern plant and equipment in excess of their depreciation in order to earn the 15-percent credit. New and growing firms would be particularly benefited. The 6-percent credit for those whose new investment expenditures fall between 50 percent and 100 percent of their depreciation allowances is designed to afford some substantial incentive to the depressed or hesitant firm which knows it cannot yet achieve the 15-percent credit.

In arriving at this form of tax encouragement to investment, careful consideration was given to other alternatives. If the credit were given across the board to all new investment, a much larger revenue loss would result from those expenditures which would have been undertaken anyway or represent no new level of effort. Our objective is to provide the largest possible inducement to new investment which would not otherwise be undertaken. Thus the plan recommended above would involve the same revenue loss—approximately \$1.7 billion—as only a 7-percent credit across the board to all new investment.

The use of current depreciation allowances as the threshold above which the higher rate of credit would apply recommends itself for a number of reasons. Depreciation reflects the average level of investment over the past, but is a less restrictive and more stable test than the use of an average of investment expenditures for a period such as the preceding 5 years. In addition, the depreciation allowances themselves in effect supply tax-free funds for investment up to this level. We now propose a tax credit—which would help to secure funds needed for the additional investment beyond that level.

The proposed credit, in terms of the revenue loss involved, will also be much more effective as an inducement to investment than an outright reduction in the rate of corporation income tax. Its benefits would be distributed more broadly, since the proposed credit will apply to individuals and partnerships as well as corporations. It will also be more effective as a direct incentive to corporate investment, and increase available funds more specifically in those corporations most likely to use them for additional investment. In short, whereas the credit will have the advantage of focusing on the profitability of new investment, much of the revenue loss under a general corporate rate reduction would be diverted into raising the profitability of old investment.

It is true that this advantage of focusing entirely on new investment is

shared by the alternative strongly urged by some—a tax change permitting more rapid depreciation of new assets (be it accelerated depreciation or an additional depreciation allowance for the first year). But the proposed investment credit would be superior, in my view, for a number of reasons. In the first place, the determination of the length of an asset's life and proper methods of depreciation have a normal and important function in determining taxable income, wholly apart from any considerations of incentive; and they should not be altered or manipulated for other purposes that would interfere with this function. It may be that on examination some of the existing depreciation rules will be found to be outmoded and inequitable; but that is a question that should be separated from investment incentives. A review of these rules and methods is underway in the Treasury Department as a part of its overall tax reform study to determine whether changes are appropriate and, if so, what form they should take. Adoption of the proposed incentive credit would in no way foreclose later action on these aspects of depreciation.

In the second place, an increase in tax depreciation tends to be recorded in the firm's accounts, thereby raising current costs and acting as a deterrent to price reduction. The proposed investment credit would not share this defect.

Finally, it is clear that the tax credit would be more effective in inducing new investment for the same revenue loss. The entire credit would be reflected immediately in the increased funds available for investment without increasing the company's future tax liability. A speedup in depreciation only postpones the timing of the tax liability on profits from the investment to a later date—an increase in profitability not comparable to that of an outright tax credit. Yet accelerated depreciation is much more costly in immediate revenues.

For example, on an average investment, a tax credit of 15 percent would bring the same return to the firm as an additional first year depreciation of over 50 percent of the cost of the investment. Yet the immediate revenue loss to the Treasury from such additional depreciation would be twice as much, and would remain considerably higher for many years. The incentive to new investment our economy needs, and which this recommendation would provide at a revenue loss of \$1.7 billion, could be supplied by an initial writeoff only at an immediate cost of \$3.4 billion.

I believe this investment tax credit will become a useful and continuous part of our tax structure. But it will be a new venture and remain in need of review. Moreover, it may prove desirable for the Congress to modify the credit from time to time, so as to adapt it to the needs of a changing economy. I strongly urge its adoption in this session.

III. TAX TREATMENT OF FOREIGN INCOME

Changing economic conditions at home and abroad, the desire to achieve greater equity in taxation, and the strains which have developed in our bal-

ance of payments position in the last few years, compel us to examine critically certain features of our tax system which, in conjunction with the tax system of other countries, consistently favor U.S. private investment abroad compared with investment in our own economy.

1. Elimination of tax deferral privileges in developed countries and "tax haven" deferral privileges in all countries: Profits earned abroad by American firms operating through foreign subsidiaries are, under present tax laws, subject to U.S. tax only when they are returned to the parent company in the form of dividends. In some cases, this tax deferral has made possible indefinite postponement of the U.S. tax; and, in those countries where income taxes are lower than in the United States, the ability to defer the payment of U.S. tax by retaining income in the subsidiary companies provides a tax advantage for companies operating through overseas subsidiaries that is not available to companies operating solely in the United States. Many American investors properly made use of this deferral in the conduct of their foreign investment. Though changing conditions now make continuance of the privilege undesirable, such change of policy implies no criticism of the investors who so utilize this privilege.

The undesirability of continuing deferral is underscored where deferral has served as a shelter for tax escape through the unjustifiable use of tax haven—so as to exploit the multiplicity more and more enterprises organized abroad by American firms have arranged their corporate structures—aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices which maximize the accumulation of profits in the tax haven—so as to exploit the multiplicity of foreign tax systems and international agreements in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad.

To the extent that these tax havens and other tax deferral privileges result in U.S. firms investing or locating abroad largely for tax reasons, the efficient allocation of international resources is upset, the initial drain on our already adverse balance of payments is never fully compensated, and profits are retained and reinvested abroad which would otherwise be invested in the United States. Certainly since the postwar reconstruction of Europe and Japan has been completed, there are no longer foreign policy reasons for providing tax incentives for foreign investment in the economically advanced countries.

If we are seeking to curb tax havens, if we recognize that the stimulus of tax deferral is no longer needed for investment in the developed countries, and if we are to emphasize investment in this country in order to stimulate our economy and our plant modernization, as well as ease our balance-of-payments

deficit, we can no longer afford existing tax treatment of foreign income.

I therefore recommend that legislation be adopted which would, after a two-step transitional period, tax each year American corporations on their current share of the undistributed profits realized in that year by subsidiary corporations organized in economically advanced countries. This current taxation would also apply to individual shareholders of closely held corporations in those countries. Since income taxes paid abroad are properly a credit against the U.S. income tax, this would subject the income from such business activities to essentially the same tax rates as business activities conducted in the United States. To permit firms to adjust their operations to this change, I also recommend that this result be achieved in equal steps over a 2-year period, under which only one-half of the profits would be affected during 1962. Where the foreign taxes paid have been close to the U.S. rates, the impact of this change would be small.

This proposal will maintain U.S. investment in the developed countries at the level justified by market forces. American enterprise abroad will continue to compete with foreign firms. With their access to capital markets at home and abroad, their advanced technical know-how, their energy, resourcefulness, and many other advantages, American firms will continue to occupy their rightful place in the markets of the world. While the rate of expansion of some American business operations abroad may be reduced through the withdrawal of tax deferral such reduction would be consistent with the efficient distribution of capital resources in the world, our balance-of-payments needs, and fairness to competing firms located in our own country.

At the same time, I recommend that tax deferral be continued for income from investment in the developing economies. The free world has a strong obligation to assist in the development of these economies, and private investment has an important contribution to make. Continued income tax deferral for these areas will be helpful in this respect. In addition, the proposed elimination of income tax deferral on U.S. earnings in industrialized countries should enhance the relative attraction of investment in the less developed countries.

On the other hand, I recommend elimination of the "tax haven" device anywhere in the world, even in the underdeveloped countries, through the elimination of tax deferral privileges for those forms of activities, such as trading, licensing, insurance and others, that typically seek out tax haven methods of operation. There is no valid reason to permit their remaining untaxed regardless of the country in which they are located.

2. Taxation of foreign investment companies: For some years now we have witnessed substantial outflows of capital from the United States into investment companies created abroad whose

principal justification lies in the tax benefits which their method of operation produces. I recommend that these tax benefits be removed and that income derived through such foreign investment companies be treated in substantially the same way as income from domestic investment companies.

3. Taxation of American citizens abroad: It is no more justifiable to provide tax exemptions for individuals living in the developed countries than it is to provide tax inducements for capital investment there. Nor should we permit totally unjustified tax benefits to be obtained by those Americans whose choice of residence is dictated primarily by their desire to minimize taxes.

I, therefore, recommend:

That the total tax exemption now accorded the earned income of American citizens residing abroad be completely terminated for those residing in economically advanced countries;

That this exemption for earned income be limited to \$20,000 for those residing in the less developed countries; and

That the exemption of \$20,000 of earned income now accorded those citizens who stay (but do not reside) abroad for 17 out of 18 months also be completely terminated for those living or traveling in the economically advanced countries.

4. Estate tax on property located abroad: I recommend that the exclusion from the estate tax accorded real property situated abroad be terminated. With the adoption several years ago of the credit for foreign taxes under the estate tax, there is no justification for the continued exemption of such property.

5. Allowance for foreign tax on dividends: Finally, the method by which the credit for foreign income taxes is computed in the case of dividends involves a double allowance for foreign income taxes and should be corrected.

These proposals, along with more detailed and technical changes needed to improve the taxation of foreign income, are expected to reduce substantially our balance of payments deficit and to increase revenues by at least \$250 million per year.

IV. CORRECTION OF OTHER STRUCTURAL DEFECTS

I next recommend a number of measures to remove other serious defects in the income tax structure. These changes, while making a beginning toward the comprehensive tax reform program mentioned above, will provide sufficient revenue gains to offset the cost of the investment tax credit and keep the revenue-producing potential of our tax structure intact.

1. Withholding on interest and dividends: Our system of combined withholding and voluntary reporting on wages and salaries under the individual income tax has served us well. Introduced during the war when the income tax was extended to millions of new taxpayers, the wage-withholding system has been one of the most important and successful advances in our tax system in recent times. Initial difficulties were quickly overcome, and the new system

helped the taxpayer no less than the tax collector.

It is the more unfortunate, therefore, that the application of the withholding principle has remained incomplete. Withholding does not apply to dividends and interest, with the result that substantial amounts of such income, particularly interest, improperly escape taxation. It is estimated that about \$3 billion of taxable interest and dividends are unreported each year. This is patently unfair to those who must as a result bear a larger share of the tax burden. Recipients of dividends and interest should pay their tax no less than those who receive wage and salary income, and the tax should be paid just as promptly. Large continued avoidance of tax on the part of some has a steadily demoralizing effect on the compliance of others.

This gap in reporting has not been appreciably lessened by educational programs. Nor can it be effectively closed by intensified enforcement measures, except by the expenditure of inordinate amounts of time and money. Withholding on corporate dividends and on investment type interest, such as interest paid on taxable government and corporate securities and savings accounts, is both necessary and practicable.

I, therefore, recommend the enactment of legislation to provide for a 20 percent withholding rate on corporate dividends and taxable investment type interest, effective January 1, 1962, under a system which would not require the preparation of withholding statements to be sent to recipients. It would thus place a relatively light burden of compliance on the payers of interest and dividends—certainly less than that placed on payers of wages and salaries—while at the same time largely solving the compliance problem for most of the taxpayers receiving dividends and interest. Steps will also be taken to avoid hardships for recipients who are not subject to tax.

The remaining need for compliance, largely in the high income group subject to a higher tax rate, would be met through the concentration of enforcement devices on taxpayers in these brackets. Introduction of equipment for the automatic processing of information returns would be especially helpful for this purpose and would thus supplement the extension of withholding.

Enactment of this proposal is estimated to increase revenue by \$600 million per year.

2. Repeal of the dividend credit and exclusion: The present law provides for an exclusion from income of the first \$50 of dividends received from domestic corporations, and for a 4 percent credit against tax of such dividend income in excess of \$50. These provisions were enacted in 1954. Proponents argued that they would encourage capital formation through equity investment, and that they would provide a partial offset to the so-called double taxation of dividend income. It is now clear that they serve neither purpose well; and I, therefore, recommend the repeal of both the dividend credit and exclusion.

The dividend credit and exclusion are not an efficient stimulus to capital expansion in the form of plant and equipment. The revenue losses resulting from these provisions are spread over a large volume of outstanding shares rather than being concentrated on new shares; and the stimulating effects of the provisions are thus greatly diluted, resulting in relatively little increases in the supply of equity funds and a relatively slight reduction in the cost of equity financing. In fact, such reduction as does occur is more likely to benefit large corporations with easy access to the capital market, while being of little use to small firms which are not so favorably situated. Insofar as raising the profitability of new investment in plant and equipment is concerned, the tax investment credit proposed above would be far more effective since it is offered to the corporation, where the actual investment decision is made.

The dividend credit and exclusion are equally inadequate as a solution to the so-called problem of double taxation. Whatever may be the merits of the arguments respecting the existence of double taxation, the provisions of the 1954 act clearly do not offer an appropriate remedy. They greatly overcompensate the dividend recipient in the high income bracket, while giving either insufficient or no relief to shareholders with smaller income.

This point deserves emphasis. For viewed simply as a means of tax reduction, the dividend credit is wholly inequitable. The distribution of its benefits is highly favorable to the taxpayers in the upper income groups who receive the major part of dividend income. Only about 10 percent of dividend income accrues to those with incomes below \$5,000; about 80 percent of it accrues to that 6.5 percent of taxpayers whose incomes exceed \$10,000 a year. Similarly, dividend income is a sharply rising fraction of total income as we move up the income scale. Thus, dividend income is about 1 percent of all income from all sources for those taxpayers with incomes of \$3,000 to \$5,000; but it constitutes more than 25 percent of the income for those with \$100,000 to \$150,000 of income, and about 50 percent for those with incomes over \$1 million.

The role of the dividend credit should not be confused with the broader question of tax rates applicable to high incomes. These high rates deserve reexamination; and this is one of the problems which will be examined in the context of next year's tax reform. But if top bracket rates were to be reduced, the dividend credit is not the way to do it. Rate reductions, if appropriate, should apply no less to those with high incomes from other sources, such as professional and salaried people whose tax position is particularly difficult today.

If the credit is eliminated, the \$50 exclusion should also be discarded for similar reasons. The tax saving from the exclusion is substantially greater for a dividend recipient with a high income than for a recipient with low income. Moreover, on equity grounds, there is no reason for giving tax reduction to that

small fraction of low income taxpayers who receive dividends in contrast to those who must live on wages, interest, rents or other forms of income.

The 1954 formula therefore is a dead end and should be rescinded, effective December 31 of this year. The estimated revenue gain is \$450 million per year.

3. Expense accounts: In recent years widespread abuses have developed through the use of the expense account. Too many firms and individuals have devised means of deducting too many personal living expenses as business expenses, thereby charging a large part of their cost to the Federal Government. Indeed, expense account living has become a byword in the American scene.

This is a matter of national concern, affecting not only our public revenues, our sense of fairness, and our respect for the tax system, but our moral and business practices as well. This widespread distortion of our business and social structure is largely a creature of the tax system, and the time has come when our tax laws should cease their encouragement of luxury spending as a charge on the Federal Treasury. The slogan—"It's deductible"—should pass from our scene.

Tighter enforcement of present legislation will not suffice. Even though in some instances entertainment and related expenses have an association with the needs of business, they nevertheless confer substantial tax-free personal benefits to the recipients. In other cases, deductions are obtained by disguising personal expenses as business outlays. But under present law, it is extremely difficult to separate out and disallow such pseudo-business expenditures. New legislation is needed to deal with the problem.

I, therefore, recommend that the cost of such business entertainment and the maintenance of entertainment facilities (such as yachts and hunting lodges) be disallowed in full as a tax deduction and that restrictions be imposed on the deductibility of business gifts, expenses of business trips combined with vacations, and excessive personal living expenses incurred on business travel away from home.

I feel confident that these measures will be welcomed by the American people. I am also confident that business firms, now forced to emulate the expense account favors of their competitors, however unsound or uneconomical such practices may be, will welcome the removal of this pressure. These measures will strengthen both our tax structure and the moral fiber of our society. These provisions should be effective as of January 1, 1962, and are estimated to increase Treasury receipts by at least \$250 million per year.

4. Capital gains on sale of depreciable business property: Another flaw which should be corrected at this time relates to the taxation of gains on the sale of depreciable business property. Such gains are now taxed at the preferential rate applicable to capital gains, even though they represent ordinary income.

This situation arises because the statutory rate of depreciation may not co-

incide with the actual decline in the value of the asset. While the taxpayer holds the property, depreciation is taken as a deduction from ordinary income. Upon its resale, where the amount of depreciation allowable exceeds the decline in the actual value of the asset so that a gain occurs, this gain under present law is taxed at the preferential capital gains rate. The advantages resulting from this practice have been increased by the liberalization of depreciation rates.

Our capital gains concept should not encompass this kind of income. This inequity should be eliminated, and especially so in view of the proposed investment credit. We should not encourage through tax incentives the further acquisition of such property as long as this loophole remains.

I therefore recommend that capital gains treatment be withdrawn from gains on the disposition of depreciable property, both personal and real property, to the extent that depreciation has been deducted for such property by the seller in previous years, permitting only the excess of the sales price over the original cost to be treated as a capital gain. The remainder should be treated as ordinary income. This reform should immediately become effective as to all sales taking place after the date of enactment. It is estimated to raise revenue by \$200 million annually.

5. Cooperatives and financial institutions: Another area of the tax laws which calls for attention is the treatment of cooperatives, private lending institutions, and fire and casualty insurance companies.

Contrary to the intention of Congress, substantial income from certain cooperative enterprises, reflecting business operations, is not being taxed either to the cooperative organization itself or its members. This situation must be corrected in a manner that is fair and just to both the cooperatives and competing businesses.

The present inequity has resulted from court decisions which held patronage refunds in certain forms to be nontaxable. I recommend that the law be clarified so that all earnings are taxable to either the cooperatives or to their patrons, assessing the patron on the earnings that are allocated to him as patronage dividends or refunds in scrip or cash. The withholding principle recommended above should also be applied to patronage dividends or refunds so that the average patron receiving scrip will, in effect, be given the cash to pay his tax on his patronage dividend or refund. The cooperatives should not be penalized by the assessment of a patronage tax upon dividends or refunds taxable to the patron but left in the business as a substitute for the sale of securities to obtain additional equity capital. The exemption for rural electric cooperatives and credit unions should be continued.

The tax provisions applicable to fire and casualty insurance companies, originally adopted in 1942, need to be reviewed in the light of current conditions. Many of these companies, or-

ganized on the mutual or reciprocal basis are now taxed under a special formula which does not take account of their underwritings gains and thus results in an inequitable distribution of the tax burden among various types of companies. Consideration should be given to taxing mutual or reciprocal companies on a basis similar to stock companies, following the pattern of similar treatment of stock and mutual enterprise in the life insurance field.

Some of the most important types of private savings and lending institutions in the country are accorded tax deductible reserve provisions which substantially reduce or eliminate their Federal income tax liability. These provisions should be reviewed with the aim of assuring nondiscriminatory treatment.

Remedial legislation in these fields would enlarge the revenues and contribute to a fair and sound tax structure.

V. TAX ADMINISTRATION

One of the major characteristics of our tax system, and one in which we can take a great deal of pride, is that it operates primarily through individual self-assessment. The integrity of such a system depends upon the continued willingness of the people honestly and accurately to discharge this annual price of citizenship. To the extent that some people are dishonest or careless in their dealings with the Government, the majority is forced to carry a heavier tax burden.

For voluntary self-assessment to be both meaningful and productive of revenues, the citizens must not only have confidence in the fairness of the tax laws, but also in their uniform and vigorous enforcement of these laws. If noncompliance by the few continues unchecked, the confidence of the many in our self-assessment system will be shaken and one of the cornerstones of our Government weakened.

I have in this message already recommended the application of withholding to dividends and interest and revisions to halt the abuses of expense accounts. These measures will improve taxpayer compliance and raise the regard of taxpayers for the fairness of our system. In addition, I propose three further measures to improve the tax enforcement machinery.

1. Taxpayer account numbers: The Internal Revenue Service has begun the installation of automatic data processing equipment to improve administration of the growing job of tax collection and enforcement. A system of identifying taxpayer account numbers, which would make possible the bringing together of all tax data for any one particular taxpayer, is an essential part of such an improved collection and enforcement program.

For this purpose, social security numbers would be used by taxpayers already having them. The small minority currently without such numbers would be assigned numbers which these persons could later use as well for social security purposes if needed. The numbers would be entered on tax returns, information returns, and related documents.

I recommend that legislation be enacted to authorize the use of taxpayer account numbers beginning January 1, 1962, to identify taxpayer accounts throughout the processing and record-keeping operations of the Internal Revenue Service.

2. Increased audit coverage: The examination of tax returns is the essence of the enforcement process. The number of examining personnel of the Internal Revenue Service, however, has been consistently inadequate to cope with the audit workload. Consequently, it has been unable to audit carefully many of the returns which should be so examined. Anticipated growth in our population will, of course, increase this enforcement problem.

Related to broadened tax audit is the criminal enforcement program of the Revenue Service. Here, the guiding principle is the creation of a deterrent to tax evasion and to maintain or, if possible, increase voluntary compliance with all taxing statutes. This means placing an appropriate degree of investigative emphasis on all types of tax violations, in all geographical areas, and identifying violations of substance in all income brackets regardless of occupation, business or profession.

Within this framework of a balanced enforcement effort, the service is placing special investigative emphasis on returns filed by persons receiving income from illegal sources. I have directed all Federal law enforcement agencies to cooperate fully with the Attorney General in a drive against organized crime, and to utilize their resources to the maximum extent in conducting investigations of individuals engaged in criminal activity on a major scale. With the foregoing in mind, I have directed the Secretary of the Treasury to provide through the Internal Revenue Service a maximum effort in this field.

To fulfill these requirements for improved audits, enforcement, and anti-crime investigation, it is essential that the Service be provided additional resources which will pay their own cost many times over. In furthering the Service's long-range plans, the prior administration asked additional appropriations of \$27.4 million to hire about 3,500 additional personnel during fiscal 1962, including provisions for the necessary increases in space and modern equipment vital to the efficient operation of the Service. To meet the commitments described above, this administration reviewed these proposals and recommended that they be increased by another \$7 million and 765 additional personnel to expedite the expansion and criminal enforcement programs. The pending alternative of only 1,995 additional personnel, or less than one-half of the number requested, this administration would constitute little more than the additional employees needed each year during the 1960's just to keep up with the estimated growth in number and complexity of returns filed. Thus I must again strongly urge the Congress to give its full support to my original request. These increases will safeguard the long-term adequacy of the Nation's

traditional voluntary compliance system and, at the same time, return the added appropriations several times over in added revenue.

3. Inventory reporting: It is increasingly apparent that the manipulation of inventories has become a frequent method of avoiding taxes. Current laws and regulations generally permit the use of inventory methods which are acceptable in recognized accounting practice. Deviations from these methods, which are not always easy to detect during examination of tax returns, can often lead to complete nonpayment of taxes until the inventories are liquidated; and, for some taxpayers, this represents permanent tax reduction. The understating of the valuation of inventories is the device most frequently used.

I have directed the Internal Revenue Service to give increasing attention to this area of tax avoidance, through a stepped-up emphasis on both the verification of the amounts reported as inventories and an examination of methods used in arriving at their reported valuation.

VI. TAX RATE EXTENSION

As recommended by my predecessor, it is again necessary that Congress enact an extension of present corporation income and excise tax rates otherwise scheduled for reduction or termination on July 1, 1961. Such extension has been adopted by the Congress on a number of previous occasions, and our present revenue requirements make such extension absolutely necessary again this year.

In the absence of such legislation, the corporate tax rate would be decreased 5 percentage points, from 52 percent to 47 percent, excise tax rates on distilled spirits, beer, wines, cigarettes, passenger automobiles, automobile parts and accessories, and the transportation of persons would also decline; and the excise tax on general telephone service would expire. We cannot afford the loss of these revenues at this time.

VII. AVIATION FUEL

The last item on the agenda relates to aviation fuel. The two previous administrations have urged that civil aviation, a mature and growing industry, be required to pay a fair share of the costs of operating and improving the Federal airways system. The rapidly mounting costs of these essential services to air transportation makes the imposition of user charges more imperative now than ever before. The most efficient method for recovering a portion of these costs equitably from the airway users is through a tax on aviation fuel. Present law provides for a net tax of 2 cents a gallon on aviation gasoline but no tax on jet fuel. The freedom from tax of jet fuel is inequitable and is resulting in substantial revenue losses due to the transition to jet-power and the resulting decline in gasoline consumption.

My predecessor recommended a flat 4½-cent tax for both aviation gasoline and jet fuels. Such a request, however, appears to be unrealistic in view of the current financial condition of the airline industry.

Therefore, I recommend extending the present net 2-cent rate on aviation gasoline to jet fuels; holding this uniform rate covering both types of fuel at the 2-cent level for fiscal 1962; and providing for annual increments in this rate of one-half cent after fiscal year 1962 until the portion of the cost of the airways properly allocable to civil aviation is substantially recovered by this tax.

The immediate increase in revenue from this proposal is modest in comparison with anticipated airways costs; and the annual gradation of further increases is intended to moderate the impact of the tax on the air carrier industry. Should future economic or other developments warrant, a more rapid increase in the fuel tax will be recommended. The decline from the revenues estimated by my predecessor is not large, and will be met by the reforms previously proposed. I repeat my earlier recommendation that, consistent with the user charge principle, revenues from the aviation fuels tax be retained in the general fund rather than diverted to the highway trust fund.

CONCLUSION

The legislation recommended in this message offers a first step toward the broader objective of tax reform. The immediate need is for encouraging economic growth through modernization and capital expansion, and to remove tax preferences for foreign investment which are no longer needed and which impair our balance of payments position. A beginning is made also toward removing some of the more glaring defects in the tax structure. The revenue gain in these proposals will offset the revenue cost of the investment credit. Finally, certain rate extensions are needed to maintain the revenue potential of our fiscal system.

These items need to be done now; but they are a first step only. They will be followed next year by a second set of proposals, aimed at thorough income tax reform. Their purpose will be to broaden and unify the income tax base, and to review the entire rate structure in the light of these revisions. Let us join in solving these immediate problems in the coming months, and then join in further action to strengthen the foundations of our revenue system.

JOHN F. KENNEDY.

The White House, April 20, 1961.

PRESIDENT'S TAX PROPOSAL REFLECTS PHILOSOPHY OF ROBIN HOOD IN REVERSE

(Mr. PELLY asked and was given permission to extend his remarks at this point in the RECORD.)

Mr. PELLY. Mr. Speaker, to me the White House message on taxation in certain respects reflects a "Robin Hood in reverse" policy. I refer to the proposal to allow big business tax exemptions for new plant expansion while taking away from 15 million little people, who have invested hard-won savings in American industry, the meager tax exemptions they have on their investments.

Later in the day, Mr. Speaker, I will elaborate on this and address my re-

marks to certain aspects of the philosophy back of the President's recommendation just read to the House.

CALL OF THE HOUSE

Mr. GROSS. Mr. Speaker, I make the point of order that a quorum is not present.

The SPEAKER. Evidently a quorum is not present.

Mr. BOLLING. Mr. Speaker, I move a call of the House.

A call of the House was ordered.

The Clerk called the roll and the following Members failed to answer to their names:

[Roll No. 39]

Auchincloss	Hollifield	Powell
Bass, Tenn.	Landrum	Roussetot
Blatnik	Macdonald	Shelley
Boggs	Moorehead,	Sheppard
Davis,	Ohio	Slack
James C.	Morse	Taylor
Dawson	Moulder	Teague, Tex.
Fenton	Nygard	Utt
Fountain	O'Hara, Mich.	Young
Harsha	Peterson	

The SPEAKER. On this rollcall 401 Members have answered to their names, a quorum.

By unanimous consent further proceedings under the call were dispensed with.

CORRECTION OF ROLLCALL

Mr. BROOKS of Louisiana. Mr. Speaker, on rollcall No. 37 yesterday, page 5912 of the RECORD, I am recorded as being absent. Mr. Speaker, I was here present, and answered to my name, the last one voting on that occasion.

The SPEAKER. Without objection, the permanent RECORD and Journal will be corrected accordingly.

There was no objection.

CONSIDERATION OF H.R. 4726, AGRICULTURAL TRADE DEVELOPMENT AND ASSISTANCE ACT OF 1954

Mr. MADDEN, from the Committee on Rules, reported the following privileged resolution (H. Res. 262, Rept. No. 255) which was referred to the House Calendar and ordered to be printed:

Resolved, That upon the adoption of this resolution it shall be in order to move that the House resolve itself into the Committee of the Whole House on the State of the Union for the consideration of the bill (H.R. 4728) to amend title I of the Agricultural Trade Development and Assistance Act of 1954, and all points of order against said bill are hereby waived. After general debate, which shall be confined to the bill and shall continue not to exceed 2 hours, to be equally divided and controlled by the chairman and ranking minority member of the Committee on Agriculture, the bill shall be read for amendment under the 5-minute rule. At the conclusion of the consideration of the bill for amendment, the Committee shall rise and report the bill to the House with such amendments as may have been adopted, and the previous question shall be considered as ordered on the bill and amendments thereto to final passage without intervening motion except one motion to recommit.

SOCIAL SECURITY AMENDMENTS OF 1961

Mr. O'NEILL. Mr. Speaker, by direction of the Committee on Rules, I call up House Resolution 258 and ask for its immediate consideration.

The Clerk read as follows:

Resolved, That upon the adoption of this resolution it shall be in order to move that the House resolve itself into the Committee of the Whole House on the State of the Union for the consideration of the bill (H.R. 6027) to improve benefits under the old-age, survivors, and disability insurance program by increasing the minimum benefits and aged widow's benefits and by making additional persons eligible for benefits under the program, and for other purposes, and all points of order against said bill are hereby waived. After general debate, which shall be confined to the bill, and shall continue not to exceed three hours, to be equally divided and controlled by the chairman and ranking minority member of the Committee on Ways and Means, the bill shall be considered as having been read for amendment. No amendments shall be in order to said bill except amendments offered by direction of the Committee on Ways and Means, but said amendments shall not be subject to amendment. At the conclusion of such consideration, the Committee shall rise and report the bill to the House with such amendments as may have been adopted, and the previous question shall be considered as ordered on the bill and amendments thereto to final passage without intervening motion, except one motion to recommit, with or without instructions.

The SPEAKER. The gentleman from Massachusetts is recognized.

Mr. O'NEILL. Mr. Speaker, I yield 30 minutes to the gentleman from Ohio [Mr. BROWN], and yield myself such time as I may use.

Mr. Speaker, House Resolution 258 provides for the consideration of H.R. 6027, a bill to improve benefits under the old-age, survivors, and disability insurance program by increasing the minimum benefits and aged widow's benefits and by making additional persons eligible for benefits under the program, and for other purposes. The resolution provides for a closed rule, waiving points of order, with 3 hours of general debate.

The proposals embodied in H.R. 6027 would provide improvements in our social insurance system. These changes will make the old-age, survivors, and disability insurance program more flexible and effective in carrying out its basic purpose, and are along the lines of the changes recommended by the President.

The bill would make benefits available for men beginning at age 62, with the benefits payable to men claiming benefits before age 65 reduced to take account of the longer period over which the benefits will be paid.

The bill would liberalize the insured status requirements so that a worker would be fully insured if he had one quarter of coverage for every year elapsing after 1950 or after the year in which he attained age 21, if that was later and up to the year of disability, death, or attainment of age 65 for men, 62 for women.

The bill would increase aged widow's, widower's, and parent's benefits from 76 to 82½ percent of the workers' retirement benefit—a 10-percent increase in benefits for these people.

Beginning in 1962, contribution rates cent each for employees and employers would be raised by one-eighth of 1 percent each for employees and employers and by three-sixteenths of 1 percent for the self-employed. The level-premium increase in cost which would result from the bill is 0.25 percent of payroll and the level-premium equivalent of the income from the increase in the contribution rates is also 0.25 percent of payroll. This means that the improvements would be fully financed and the system would remain actuarially sound.

The old-age, survivors, and disability insurance program, providing as it does a regular income for many millions of families who might otherwise be without the basic means of subsistence, is one of the most important of our economic stabilizers. Under the improvements recommended in the bill, additional purchasing power will be placed in the hands of people who very much need it. These proposed changes would benefit about 4,420,000 people within the first 12 months through new or increased benefits amounting to \$780 million. The changes constitute desirable and sound longrun improvements in the system.

Consistent with policies established by the Congress in the past, the improvements made by the bill will be fully financed and the program will continue to be self-supporting and on a sound actuarial basis.

Mr. Speaker, I urge the adoption of House Resolution 258.

Mr. BROWN. Mr. Speaker, I yield myself such time as I might consume.

(Mr. BROWN asked and was given permission to revise and extend his remarks.)

Mr. BROWN. Mr. Speaker, the gentleman from Massachusetts [Mr. O'NEILL], has explained something of the provisions of the rule making this bill in order for consideration.

However, I think I should call the attention of the House to the fact that this is another occasion where we might say, "Here we go again," because once more we have before us a closed or gag rule which, of course, will prohibit or prevent any Member of this House from offering any amendment to this measure, except those amendments which may be approved by the majority membership of the Committee on Ways and Means. Of course, this means there will be no opportunity to vote on any amendment except submitted in the form of a motion to recommit with instructions.

There are those who will say this is the usual rule, and of course it has been the usual practice in this House to have closed or gag rules on various types of tax bills, including some of the measures of the past dealing with social security matters. However, that has not always been the situation by any means

87TH CONGRESS
2^D SESSION

H. R. 10650

IN THE HOUSE OF REPRESENTATIVES

MARCH 12, 1962

Mr. MILLS introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE, ETC.**

4 (a) **SHORT TITLE.**—This Act may be cited as the
5 “Revenue Act of 1962”.

1 (b) TABLE OF CONTENTS.—

- Sec. 1. Short title, etc.
 - (a) Short title.
 - (b) Table of contents.
 - (c) Amendment of 1954 code.
- Sec. 2. Credit for investment in certain depreciable property.
 - (a) Allowance of credit.
 - (b) Rules for computing credit.
 - (c) Certain corporate acquisitions.
 - (d) Clerical amendment.
 - (e) Effective date.
- Sec. 3. Appearances, etc., with respect to legislation.
 - (a) In general.
 - (b) Effective date.
- Sec. 4. Disallowance of certain entertainment, etc., expenses.
 - (a) Denial of deduction.
 - (b) Traveling expenses.
 - (c) Effective date.
- Sec. 5. Amount of distribution where certain foreign corporations distribute property in kind.
 - (a) Amount distributed.
 - (b) Basis.
 - (c) Dividends received from certain foreign corporations.
 - (d) Credit for foreign taxes.
 - (e) Effective date.
- Sec. 6. Amendment of section 482.
 - (a) In general.
 - (b) Clerical amendment.
 - (c) Effective date.
- Sec. 7. Distributions of foreign personal holding company income.
 - (a) Definition of foreign personal holding company.
 - (b) Amount of undistributed income.
 - (c) Effective date.
- Sec. 8. Mutual savings banks, etc.
 - (a) Reserves for losses on loans.
 - (b) Foreclosure on property securing loans.
 - (c) Definition of domestic building and loan association.
 - (d) Clerical amendments.
 - (e) Repeal of exemption from communications and transportation of persons taxes.
 - (f) Effective dates.
- Sec. 9. Distributions by foreign trusts.
 - (a) Definitions.
 - (b) Accumulation distributions of foreign trusts.

- (c) Allocation of accumulation distributions to preceding years.
- (d) Amounts treated as received in prior years.
- (e) Special rules for foreign trusts.
- (f) Information returns with respect to foreign trusts.
- (g) Failure to file information returns.
- (h) United States person defined.
- (i) Technical amendments.
- (j) Effective date.

Sec. 10. Mutual insurance companies (other than life, marine, and certain fire insurance companies), etc.

- (a) Imposition of tax.
- (b) Taxable investment income.
- (c) Statutory underwriting income or loss.
- (d) Mutual fire insurance companies operating on basis of premium deposits.
- (e) Election of certain mutual companies to be taxed on total income.
- (f) Technical amendments, etc.
- (g) Effective date.

Sec. 11. Domestic corporations receiving dividends from foreign corporations.

- (a) Entire amount of foreign tax to be taken into account.
- (b) Inclusion in gross income of amount equal to taxes deemed paid.
- (c) Determination of source of dividends received from certain foreign corporations.
- (d) Repeal of section 902(d).
- (e) Technical amendments.
- (f) Effective date.

Sec. 12. Earned income from sources without the United States.

- (a) Limitation on amount and type of income excluded.
- (b) Computation of employees' contributions.
- (c) Effective date.

Sec. 13. Controlled foreign corporations.

- (a) In general.
- (b) Technical and clerical amendments.
- (c) Effective date.

Sec. 14. Gain from dispositions of certain depreciable property.

- (a) In general.
- (b) Change in method of depreciation.
- (c) Salvage value of personal property.
- (d) Special rule for charitable contributions of section 1245 property.
- (e) Technical amendments.
- (f) Effective date.

Sec. 15. Foreign investment companies.

- (a) Treatment of sale of stock of foreign investment companies.
- (b) Conforming amendments.
- (c) Effective date.

Sec. 16. Gain from certain sales or exchanges of stock in certain foreign corporations.

- (a) Treatment of gain from the redemption, cancellation, or sale of stock in certain foreign corporations.
- (b) Clerical amendment.
- (c) Effective date.

Sec. 17. Tax treatment of cooperatives and patrons.

- (a) In general.
- (b) Technical amendments.
- (c) Effective dates.

Sec. 18. Inclusion of foreign real property in gross estate.

- (a) Amendments to include foreign real property.
- (b) Effective date.

Sec. 19. Withholding of income tax at source on interest, dividends, and patronage dividends.

- (a) In general.
- (b) Credits against income tax for tax withheld.
- (c) Interest and dividends paid to nonresident aliens, etc.
- (d) Credit for States and tax-exempt organizations.
- (e) Other technical amendments.
- (f) Effective dates.

Sec. 20. Information with respect to certain foreign entities.

- (a) Information to be furnished by individuals, domestic corporations, etc., with respect to certain foreign corporations.
- (b) Information as to organization or reorganization of foreign corporations and as to acquisitions of their stock.
- (c) Civil penalty for failure to file return.
- (d) Technical amendments.
- (e) Effective date.

Sec. 21. Treaties.

1 (c) AMENDMENT OF 1954 CODE.—Whenever in this
2 Act an amendment or repeal is expressed in terms of an
3 amendment to, or repeal of, a section or other provision,
4 the reference shall be considered to be made to a section or
5 other provision of the Internal Revenue Code of 1954.

6 **SEC. 2. CREDIT FOR INVESTMENT IN CERTAIN DEPRE-**
7 **CIABLE PROPERTY.**

8 (a) ALLOWANCE OF CREDIT.—Part IV of subchapter
9 A of chapter 1 (relating to credits against tax) is amended
10 by redesignating section 38 as section 40 and by inserting
11 after section 37 the following new section:

12 **“SEC. 38. INVESTMENT IN CERTAIN DEPRECIABLE PROP-**
13 **ERTY.**

14 “(a) GENERAL RULE.—There shall be allowed, as a
15 credit against the tax imposed by this chapter, the amount
16 determined under subpart B of this part.

17 “(b) REGULATIONS.—The Secretary or his delegate
18 shall prescribe such regulations as may be necessary to carry
19 out the purposes of this section and subpart B.”

20 (b) RULES FOR COMPUTING CREDIT.—Part IV of sub-

chapter A of chapter 1 is amended by adding at the end thereof the following new subpart:

**“Subpart B—Rules for Computing Credit for Investment
in Certain Depreciable Property**

“Sec. 46. Amount of credit.

“Sec. 47. Certain dispositions, etc., of section 38 property.

“Sec. 48. Definitions; special rules.

“SEC. 46. AMOUNT OF CREDIT.

“(a) DETERMINATION OF AMOUNT.—

“(1) GENERAL RULE.—The amount of the credit allowed by section 38 for the taxable year shall be equal to 8 percent of the qualified investment (as defined in subsection (c)).

“(2) LIMITATION BASED ON AMOUNT OF TAX.—Notwithstanding paragraph (1), the credit allowed by section 38 for the taxable year shall not exceed—

“(A) so much of the liability for tax for the taxable year as does not exceed \$100,000, plus

“(B) 50 percent of so much of the liability for tax for the taxable year as exceeds \$100,000.

“(3) LIABILITY FOR TAX.—For purposes of paragraph (2), the liability for tax for the taxable year shall be the tax imposed by this chapter for such year, reduced by the sum of the credits allowable under—

“(A) section 33 (relating to foreign tax credit),

1 “(B) section 34 (relating to dividends re-
2 ceived by individuals),

3 “(C) section 35 (relating to partially tax-
4 exempt interest), and

5 “(D) section 37 (relating to retirement in-
6 come).

7 For purposes of this paragraph, any tax imposed for the
8 taxable year by section 531 (relating to accumulated
9 earnings tax) or by section 541 (relating to personal
10 holding company tax) shall not be considered tax
11 imposed by this chapter for such year.

12 “(4) MARRIED INDIVIDUALS.—In the case of a
13 husband or wife who files a separate return, the amount
14 specified under subparagraphs (A) and (B) of para-
15 graph (2) shall be \$50,000 in lieu of \$100,000. This
16 paragraph shall not apply if the spouse of the taxpayer
17 has no qualified investment for, and no unused credit
18 carryover to, the taxable year of such spouse which ends
19 within or with the taxpayer’s taxable year.

20 “(5) AFFILIATED GROUPS.—In the case of an
21 affiliated group, the \$100,000 amount specified under
22 subparagraphs (A) and (B) of paragraph (2) shall be
23 reduced for each member of the group by apportioning
24 \$100,000 among the members of such group in such
25 manner as the Secretary or his delegate shall by regula-

1 tions prescribe. For purposes of the preceding sentence,
2 the term 'affiliated group' has the meaning assigned to
3 such term by section 1504 (a), except that all corpora-
4 tions shall be treated as includible corporations (with-
5 out any exclusion under section 1504 (b)).

6 “(b) 5-YEAR CARRYOVER OF UNUSED CREDITS.—

7 “(1) ALLOWANCE OF CREDIT.—If the amount of
8 the credit determined under subsection (a) (1) for any
9 taxable year exceeds the limitation provided by subsec-
10 tion (a) (2) for such taxable year (hereinafter in this
11 subsection referred to as 'unused credit year'), such
12 excess shall be added to the amount allowable as a credit
13 by section 38 for each of the 5 succeeding taxable years
14 to the extent not taken into account for taxable years
15 intervening between the unused credit year and such
16 succeeding taxable year.

17 “(2) LIMITATION.—The amount of the unused
18 credit which may be added under paragraph (1) for any
19 succeeding taxable year shall not exceed the amount by
20 which the limitation provided by subsection (a) (2) for
21 such taxable year exceeds the sum of—

22 “(A) the credit allowable under subsection
23 (a) (1) for such taxable year, and

24 “(B) the amounts which, by reason of this
25 subsection, are added to the amount allowable for

such taxable year and attributable to taxable years preceding the unused credit year.

“(c) QUALIFIED INVESTMENT.—

“(1) IN GENERAL.—For purposes of this subpart, the term ‘qualified investment’ means, with respect to any taxable year, the aggregate of—

“(A) the applicable percentage of the basis of each new section 38 property (as defined in section 48 (b)) placed in service by the taxpayer during such taxable year, plus

“(B) the applicable percentage of the cost of each used section 38 property (as defined in section 48 (c) (1)) placed in service by the taxpayer during such taxable year.

“(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the applicable percentage for any property shall be determined under the following table:

“If the useful life is—	The applicable percentage is—
4 years or more but less than 6 years.....	33⅓
6 years or more but less than 8 years.....	66⅔
8 years or more.....	100

For purposes of this paragraph, the useful life of any property shall be determined as of the time such property is placed in service by the taxpayer.

1 “(3) PUBLIC UTILITY PROPERTY.—

2 “(A) In the case of section 38 property which
3 is public utility property, the amount of the qualified
4 investment shall be 50 percent of the amount deter-
5 mined under paragraph (1).

6 “(B) For purposes of subparagraph (A), the
7 term ‘public utility property’ means property used
8 predominantly in the trade or business of the fur-
9 nishing or sale of—

10 “(i) electrical energy, water, or sewage
11 disposal services,

12 “(ii) gas through a local distribution sys-
13 tem,

14 “(iii) telephone service, or

15 “(iv) telegraph service by means of do-
16 mestic telegraph operations (as defined in
17 section 222 (a) (5) of the Communications Act
18 of 1934, as amended; 47 U.S.C., sec. 222 (a)
19 (5)),

20 if the rates for such furnishing or sale, as the case
21 may be, have been established or approved by a
22 State or political subdivision thereof, by an agency
23 or instrumentality of the United States, or by a
24 public service or public utility commission or other

similar body of any State or political subdivision thereof.

“(d) LIMITATIONS WITH RESPECT TO CERTAIN PERSONS.—

“(1) IN GENERAL.—In the case of—

“(A) an organization to which section 593 applies,

“(B) a regulated investment company or a real estate investment trust subject to taxation under subchapter M (sec. 851 and following), and

“(C) a cooperative organization described in section 1381 (a),

the qualified investment and the \$100,000 amount specified under subparagraphs (A) and (B) of subsection (a) (2) shall equal such person's ratable share of such items.

“(2) RATABLE SHARE.—For purposes of paragraph (1), the ratable share of any person for any taxable year of the items described therein shall be—

“(A) in the case of an organization referred to in paragraph (1) (A), 50 percent thereof,

“(B) in the case of a regulated investment company or a real estate investment trust, the ratio

(i) the numerator of which is its taxable income and

1 (ii) the denominator of which is its taxable income
2 computed without regard to the deduction for divi-
3 dends paid provided by section 852 (b) (2) (D) or
4 857 (b) (2) (C), as the case may be, and

5 “(C) in the case of a cooperative organization,
6 the ratio (i) the numerator of which is its taxable
7 income and (ii) the denominator of which is its
8 taxable income increased by amounts to which
9 section 1382 (b) or (c) applies and similar amounts
10 the tax treatment of which is determined without
11 regard to subchapter T (sec. 1381 and following).

12 For purposes of subparagraph (B) of the preceding
13 sentence, the term ‘taxable income’ means in the case of
14 a regulated investment company its investment company
15 taxable income (within the meaning of section
16 852 (b) (2)), and in the case of a real estate invest-
17 ment trust its real estate investment trust taxable in-
18 come (within the meaning of section 857 (b) (2)).

19 **“SEC. 47. CERTAIN DISPOSITIONS, ETC., OF SECTION 38**
20 **PROPERTY.**

21 “(a) **GENERAL RULE.**—Under regulations prescribed
22 by the Secretary or his delegate—

23 “(1) **EARLY DISPOSITION, ETC.**—If during any tax-
24 able year any property is disposed of, or otherwise

1 ceases to be section 38 property with respect to the tax-
2 payer, before the close of the useful life which was taken
3 into account in computing the credit under section 38,
4 then the tax under this chapter for such taxable year
5 shall be increased by an amount equal to the aggregate
6 decrease in the credits allowed under section 38 for all
7 prior taxable years which would have resulted solely
8 from substituting, in determining qualified investment,
9 for such useful life the period beginning with the time
10 such property was placed in service by the taxpayer and
11 ending with the time such property ceased to be section
12 38 property.

13 “(2) PROPERTY BECOMES PUBLIC UTILITY PROP-
14 ERTY.—If during any taxable year any property taken
15 into account in determining qualified investment becomes
16 public utility property (within the meaning of section
17 46(c)(3)(B)), then the tax under this chapter for
18 such taxable year shall be increased by an amount equal
19 to the aggregate decrease in the credits allowed under
20 section 38 for all prior taxable years which would have
21 resulted solely from treating the property, for purposes
22 of determining qualified investment, as public utility
23 property (after giving due regard to the period before
24 such change in use). If the application of this paragraph

1 to any property is followed by the application of para-
 2 graph (1) to such property, proper adjustment shall be
 3 made in applying paragraph (1).

4 “(3) CARRYOVERS ADJUSTED.—In the case of
 5 any cessation described in paragraph (1) or any
 6 change in use described in paragraph (2), the carry-
 7 overs under section 46(b) shall be adjusted by reason
 8 of such cessation (or change in use).

9 “(b) SECTION NOT TO APPLY IN CERTAIN CASES.—
 10 Subsection (a) shall not apply to—

11 “(1) a transfer by reason of death, or

12 “(2) a transaction to which section 381(a) applies.

13 For purposes of subsection (a), property shall not be treated
 14 as ceasing to be section 38 property with respect to the tax-
 15 payer by reason of a mere change in the form of conducting
 16 the trade or business so long as the property is retained in
 17 such trade or business as section 38 property and the tax-
 18 payer retains a substantial interest in such trade or business.

19 “(c) SPECIAL RULE.—Any increase in tax under sub-
 20 section (a) shall not be treated as tax imposed by this
 21 chapter for purposes of determining the amount of any credit
 22 allowable under subpart A.

1 “SEC. 48. DEFINITIONS; SPECIAL RULES.

2 “(a) SECTION 38 PROPERTY.—

3 “(1) IN GENERAL.—Except as provided in this
4 subsection, the term ‘section 38 property’ means—

5 “(A) tangible personal property, or

6 “(B) other tangible property (not including
7 a building and its structural components) but only
8 if such property—

9 “(i) is used as an integral part of manu-
10 facturing, production, or extraction or of fur-
11 nishing transportation, communications, elec-
12 trical energy, gas, water, or sewage disposal
13 services, or

14 “(ii) constitutes a research or storage fa-
15 cility used in connection with any of the activi-
16 ties referred to in clause (i).

17 Such term includes only property with respect to which
18 depreciation (or amortization in lieu of depreciation) is
19 allowable and having a useful life (determined as of
20 the time such property is placed in service) of 4 years
21 or more.

1 “(2) PROPERTY USED OUTSIDE THE UNITED
2 STATES.—

3 “(A) IN GENERAL.—Except as provided in
4 subparagraph (B), the term ‘section 38 property’
5 does not include property which is used predomi-
6 nantly outside the United States.

7 “(B) EXCEPTIONS.—Subparagraph (A) shall
8 not apply to—

9 “(i) any aircraft which is registered by
10 the Administrator of the Federal Aviation
11 Agency and which is operated to and from the
12 United States;

13 “(ii) rolling stock, of a domestic railroad
14 corporation subject to part I of the Interstate
15 Commerce Act, which is used within and with-
16 out the United States;

17 “(iii) any vessel documented under the
18 laws of the United States which is operated in
19 the foreign or domestic commerce of the United
20 States;

21 “(iv) any motor vehicle of a United States
22 person (as defined in section 7701 (a) (30))
23 which is operated to and from the United
24 States;

25 “(v) any container of a United States

person which is used in the transportation of property to and from the United States; and

“(vi) any property (other than a vessel or an aircraft) of a United States person which is used for the purpose of exploring for, developing, removing, or transporting resources from the outer Continental Shelf (within the meaning of section 2 of the Outer Continental Shelf Lands Act, as amended and supplemented; 43 U.S.C., sec. 1331).

“(3) PROPERTY USED FOR LODGING.—Property which is used predominantly to furnish lodging or in connection with the furnishing of lodging shall not be treated as section 38 property. The preceding sentence shall not apply to—

“(A) nonlodging commercial facilities which are available to persons not using the lodging facilities on the same basis as they are available to persons using the lodging facilities, and

“(B) property used by a hotel or motel in connection with the trade or business of furnishing lodging where the predominant portion of the accommodations is used by transients.

“(4) PROPERTY USED BY CERTAIN TAX-EXEMPT

1 ORGANIZATIONS.—Property used by an organization
2 (other than a cooperative described in section 521)
3 which is exempt from the tax imposed by this chapter
4 shall be treated as section 38 property only if such
5 property is used predominantly in an unrelated trade or
6 business the income of which is subject to tax under
7 section 511.

8 “(5) PROPERTY USED BY GOVERNMENTAL
9 UNITS.—Property used by the United States, any State
10 or political subdivision thereof, any international organ-
11 ization, or any agency or instrumentality of any of the
12 foregoing shall not be treated as section 38 property.

13 “(b) NEW SECTION 38 PROPERTY.—For purposes of
14 this subpart, the term ‘new section 38 property’ means sec-
15 tion 38 property—

16 “(1) the construction, reconstruction, or erection
17 of which is completed by the taxpayer after December
18 31, 1961, or

19 “(2) acquired after December 31, 1961, if the
20 original use of such property commences with the tax-
21 payer and commences after such date.

22 In applying section 46(c)(1)(A) in the case of property
23 described in paragraph (1), there shall be taken into account

1 only that portion of the basis which is properly attributable
2 to construction, reconstruction, or erection after December
3 31, 1961.

4 “(c) USED SECTION 38 PROPERTY.—

5 “(1) IN GENERAL.—For purposes of this subpart,
6 the term ‘used section 38 property’ means section 38
7 property acquired by purchase after December 31, 1961,
8 which is not new section 38 property. Property shall
9 not be treated as ‘used section 38 property’ if, after its
10 acquisition by the taxpayer, it is used by a person who
11 used such property before such acquisition (or by a
12 person who bears a relationship described in section
13 179 (d) (2) (A) or (B) to a person who used such
14 property before such acquisition).

15 “(2) DOLLAR LIMITATION.—

16 “(A) IN GENERAL.—The cost of used section
17 38 property taken into account under section 46
18 (c) (1) (B) for any taxable year shall not exceed
19 \$50,000. If such cost exceeds \$50,000, the tax-
20 payer shall select (at such time and in such manner
21 as the Secretary or his delegate shall by regulations
22 prescribe) the items to be taken into account, but
23 only to the extent of an aggregate cost of \$50,000.

1 Such a selection, once made, may be changed only
2 in the manner, and to the extent, provided by such
3 regulations.

4 “(B) MARRIED INDIVIDUALS.—In the case of
5 a husband or wife who files a separate return, the
6 limitation under subparagraph (A) shall be
7 \$25,000 in lieu of \$50,000. This subparagraph
8 shall not apply if the spouse of the taxpayer has no
9 used section 38 property which may be taken into
10 account as qualified investment for the taxable year
11 of such spouse which ends within or with the tax-
12 payer’s taxable year.

13 “(C) AFFILIATED GROUPS.—In the case of an
14 affiliated group, the \$50,000 amount specified under
15 subparagraph (A) shall be reduced for each mem-
16 ber of the group by apportioning \$50,000 among
17 the members of such group in accordance with their
18 respective amounts of used section 38 property
19 which may be taken into account.

20 “(D) PARTNERSHIPS.—In the case of a part-
21 nership, the limitation contained in subparagraph
22 (A) shall apply with respect to the partnership and
23 with respect to each partner.

24 “(3) DEFINITIONS.—For purposes of this sub-
25 section—

1 “(A) PURCHASE.—The term ‘purchase’ has
2 the meaning assigned to such term by section
3 179 (d) (2) .

4 “(B) COST.—The cost of used section 38
5 property does not include so much of the basis of
6 such property as is determined by reference to the
7 adjusted basis of other property held at any time by
8 the person acquiring such property. If property is
9 disposed of and used section 38 property similar or
10 related in service or use is acquired as a replace-
11 ment therefor in a transaction to which the pre-
12 ceding sentence does not apply, the cost of the used
13 section 38 property acquired shall be its basis re-
14 duced by the adjusted basis of the property re-
15 placed. The cost of used section 38 property shall
16 not be reduced with respect to the adjusted basis of
17 any property disposed of if, by reason of section 47,
18 such disposition involved an increase of tax or
19 a reduction of the unused credit carryovers described
20 in section 46 (b) .

21 “(C) AFFILIATED GROUP.—The term ‘affili-
22 ated group’ has the meaning assigned to such term
23 by section 1504 (a) , except that—

24 “(i) the phrase ‘more than 50 percent’
25 shall be substituted for the phrase ‘at least 80

1 percent' each place it appears in section
2 1504 (a), and

3 “(ii) all corporations shall be treated as
4 includible corporations (without any exclusion
5 under section 1504 (b)).

6 “(d) CERTAIN LEASED PROPERTY.—A person (other
7 than a person referred to in section 46 (d)) engaged in the
8 business of leasing property may (at such time, in such
9 manner, and subject to such conditions as are provided by
10 regulations prescribed by the Secretary or his delegate)
11 elect with respect to any new section 38 property to treat
12 the lessee as having acquired such property for an amount
13 equal to—

14 “(1) if such property was constructed by the lessor
15 (or by a corporation which controls or is controlled by
16 the lessor within the meaning of section 368 (c)), the
17 fair market value of such property, or

18 “(2) if paragraph (1) does not apply, the basis
19 of such property to the lessor.

20 The election provided by the preceding sentence may be
21 made only with respect to property which would be new
22 section 38 property if acquired by the lessee. For purposes
23 of the preceding sentence and section 46 (c) , the useful life
24 of property in the hands of the lessee is the useful life of such
25 property in the hands of the lessor. If a lessor makes the

1 election provided by this subsection with respect to any
2 property, the lessee shall be treated for all purposes of this
3 subpart as having acquired such property.

4 “(e) SUBCHAPTER S CORPORATIONS.—In the case of
5 an electing small business corporation (as defined in section
6 1371)—

7 “(1) the qualified investment for each taxable year
8 shall be apportioned pro rata among the persons who
9 are shareholders of such corporation on the last day of
10 such taxable year; and

11 “(2) any person to whom any investment has been
12 apportioned under paragraph (1) shall be treated (for
13 purposes of this subpart) as the taxpayer with respect
14 to such investment, and such investment shall not (by
15 reason of such apportionment) lose its character as an
16 investment in new section 38 property or used section
17 38 property, as the case may be.

18 “(f) ESTATES AND TRUSTS.—In the case of an estate
19 or trust—

20 “(1) the qualified investment for any taxable year
21 shall be apportioned between the estate or trust and the
22 beneficiaries on the basis of the income of the estate or
23 trust allocable to each,

24 “(2) any beneficiary to whom any investment has
25 been apportioned under paragraph (1) shall be treated

1 (for purposes of this subpart) as the taxpayer with re-
 2 spect to such investment, and such investment shall not
 3 (by reason of such apportionment) lose its character as
 4 an investment in new section 38 property or used section
 5 38 property, as the case may be, and

6 “(3) the \$100,000 amount specified under sub-
 7 paragraphs (A) and (B) of section 46(a)(2) ap-
 8 plicable to such estate or trust shall be reduced to an
 9 amount which bears the same ratio to \$100,000 as the
 10 amount of the qualified investment allocated to the
 11 estate or trust under paragraph (1) bears to the entire
 12 amount of the qualified investment.

13 “(g) CROSS REFERENCE.—

“For application of this subpart to certain acquiring corporations, see section 381(c)(23).”

14 (c) CERTAIN CORPORATE ACQUISITIONS.—Section
 15 381(c) (relating to items taken into account in certain
 16 corporate acquisitions) is amended by adding at the end
 17 thereof the following new paragraph:

18 “(23) CREDIT UNDER SECTION 38 FOR INVEST-
 19 MENT IN CERTAIN DEPRECIABLE PROPERTY.—The ac-
 20 quiring corporation shall take into account (to the ex-
 21 tent proper to carry out the purposes of this section and
 22 section 38, and under such regulations as may be pre-
 23 scribed by the Secretary or his delegate) the items re-

quired to be taken into account for purposes of section 38 in respect of the distributor or transferor corporation.”

(d) CLERICAL AMENDMENT.—Part IV of subchapter A of chapter 1 is amended by inserting after the heading and before the table of sections the following:

“Subpart A. Credits allowable.

“Subpart B. Rules for computing credit for investment in certain depreciable property.

“Subpart A—Credits Allowable”

(e) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years ending after December 31, 1961.

SEC. 3. APPEARANCES, ETC., WITH RESPECT TO LEGISLATION.

(a) IN GENERAL.—Section 162 (relating to trade or business expenses) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

“(e) APPEARANCES, ETC., WITH RESPECT TO LEGISLATION.—

“(1) IN GENERAL.—The deduction allowed by subsection (a) shall include all the ordinary and necessary expenses (including, but not limited to, traveling expenses described in subsection (a) (2) and the cost

1 of preparing testimony) paid or incurred during the tax-
2 able year in carrying on any trade or business—

3 “(A) in direct connection with appearances
4 before, submission of statements to, or sending com-
5 munications to, the committees, or individual mem-
6 bers, of Congress or of any legislative body of a
7 State, a possession of the United States, or a politi-
8 cal subdivision of any of the foregoing with respect
9 to legislation or proposed legislation of direct inter-
10 est to the taxpayer, or

11 “(B) in direct connection with communication
12 of information between the taxpayer and an organ-
13 ization of which he is a member with respect to
14 legislation or proposed legislation of direct interest
15 to the taxpayer and to such organization,
16 and that portion of the dues so paid or incurred with
17 respect to any organization of which the taxpayer is a
18 member which is attributable to the expenses of the
19 activities described in subparagraphs (A) and (B)
20 carried on by such organization.

21 “(2) LIMITATION.—The provisions of paragraph
22 (1) shall not be construed as allowing the deduction of
23 any amount paid or incurred (whether by way of con-
24 tribution, gift, or otherwise) —

25 “(A) for participation in, or intervention in,

any political campaign on behalf of any candidate
for public office, or

“(B) in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums.”

(b) **EFFECTIVE DATE.**—The amendments made by this section shall apply to taxable years beginning after December 31, 1962.

**SEC. 4. DISALLOWANCE OF CERTAIN ENTERTAINMENT,
ETC., EXPENSES.**

(a) **DENIAL OF DEDUCTION.**—

(1) Part IX of subchapter B of chapter 1 (relating to items not deductible in computing taxable income) is amended by adding at the end thereof the following new section:

**“SEC. 274. DISALLOWANCE OF CERTAIN ENTERTAINMENT,
ETC., EXPENSES.**

“(a) **ENTERTAINMENT, AMUSEMENT, OR RECREATION.**—

“(1) **IN GENERAL.**—No deduction otherwise allowable under this chapter shall be allowed for any item—

“(A) **ACTIVITY.**—With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless

1 the taxpayer establishes that the item was directly
2 related to the active conduct of the taxpayer's trade
3 or business, or

4 “(B) FACILITY.—With respect to a facility
5 used in connection with an activity referred to in
6 subparagraph (A), unless the taxpayer establishes
7 that the facility was used primarily for the further-
8 ance of the taxpayer's trade or business and that the
9 item was directly related to the active conduct of
10 such trade or business,

11 and such deduction shall in no event exceed the portion
12 of such item directly related to the active conduct of the
13 taxpayer's trade or business.

14 “(2) SPECIAL RULES.—For purposes of applying
15 paragraph (1) —

16 “(A) Dues or fees to any social, athletic, or
17 sporting club or organization shall be treated as
18 items with respect to facilities.

19 “(B) An activity described in section 212
20 shall be treated as a trade or business.

21 “(b) GIFTS.—

22 “(1) LIMITATION.—No deduction shall be allowed
23 under section 162 or section 212 for any expense for
24 gifts made directly or indirectly to any individual to the
25 extent that such expense, when added to prior expenses

1 of the taxpayer for gifts made to such individual during
2 the same taxable year, exceeds \$25. For purposes of
3 this section, the term 'gift' means any item excludable
4 from gross income of the recipient under section 102
5 which is not excludable from his gross income under any
6 other provision of this chapter.

7 “(2) SPECIAL RULES.—

8 “(A) In the case of a gift by a partnership, the
9 limitation contained in paragraph (1) shall apply
10 to the partnership as well as to each member thereof.

11 “(B) For purposes of paragraph (1), a hus-
12 band and wife shall be treated as one taxpayer.

13 “(c) SUBSTANTIATION REQUIRED.—No deduction shall
14 be allowed—

15 “(1) under section 162 or 212 for any traveling
16 expense (including meals and lodging while away from
17 home),

18 “(2) for any item with respect to an activity which
19 is of a type generally considered to constitute entertain-
20 ment, amusement, or recreation, or with respect to a
21 facility used in connection with such an activity, or

22 “(3) for any expense for gifts,

23 unless the taxpayer substantiates by adequate records or by
24 sufficient evidence corroborating his own statement (A) the
25 amount of such expense or other item, (B) the time and

1 place of the travel, entertainment, amusement, recreation, or
 2 use of the facility, or the date and description of the gift, (C)
 3 the business purpose of the expense or other item, and (D)
 4 the business relationship to the taxpayer of persons enter-
 5 tained, using the facility, or receiving the gift. The Secre-
 6 tary or his delegate may by regulations provide that some
 7 or all of the requirements of the preceding sentence shall not
 8 apply in the case of an expense which does not exceed an
 9 amount prescribed pursuant to such regulations.

10 “(d) SPECIFIC EXCEPTIONS TO APPLICATION OF SUB-
 11 SECTION (a).—Subsection (a) shall not apply to—

12 “(1) BUSINESS MEALS.—Expenses for food and
 13 beverages furnished to any individual under circum-
 14 stances which (taking into account the surroundings in
 15 which furnished, the taxpayer’s trade, business, or in-
 16 come-producing activity and the relationship to such
 17 trade, business, or activity of the persons to whom the
 18 food and beverages are furnished) are of a type generally
 19 considered to be conducive to a business discussion.

20 “(2) FOOD AND BEVERAGES FOR EMPLOYEES.—
 21 Expenses for food and beverages (and facilities used
 22 in connection therewith) furnished on the business prem-
 23 ises of the taxpayer primarily for his employees.

24 “(3) EXPENSES TREATED AS COMPENSATION.—
 25 Expenses for goods, services, and facilities, to the ex-

1 tent that the expenses are treated by the taxpayer, with
2 respect to the recipient of the entertainment, amusement,
3 or recreation, as compensation to an employee on the
4 taxpayer's return of tax under this chapter and as wages
5 to such employee for purposes of chapter 24 (relating
6 to withholding of income tax at source on wages) .

7 “(4) REIMBURSED EXPENSES.—Expenses paid or
8 incurred by the taxpayer, in connection with the per-
9 formance by him of services for another person
10 (whether or not such other person is his employer),
11 under a reimbursement or other expense allowance
12 arrangement with such other person, but this para-
13 graph shall apply—

14 “(A) where the services are performed for
15 an employer, only if the employer has not treated
16 such expenses in the manner provided in paragraph
17 (3), or

18 “(B) where the services are performed for a
19 person other than an employer, only if the tax-
20 payer accounts (to the extent provided by sub-
21 section (c)) to such person.

22 “(5) RECREATIONAL, ETC., EXPENSES FOR EM-
23 PLOYEES.—Expenses for recreational, social, or similar
24 activities (including facilities therefor) primarily for
25 the benefit of employees (other than employees who

1 are officers, shareholders or other owners, or highly
2 compensated employees). For purposes of this para-
3 graph, an individual owning less than a 10-percent in-
4 terest in the taxpayer's trade or business shall not be
5 considered a shareholder or other owner, and for such
6 purposes an individual shall be treated as owning any
7 interest owned by a member of his family (within the
8 meaning of section 267 (c) (4)).

9 “(6) EMPLOYEE AND STOCKHOLDER BUSINESS
10 MEETINGS.—Expenses directly related to business meet-
11 ings of employees or stockholders.

12 “(7) MEETINGS OF BUSINESS LEAGUES, ETC.—
13 Expenses directly related and necessary to attendance at
14 a business meeting or convention of any organization
15 described in section 501 (c) (6) (relating to business
16 leagues, chambers of commerce, real estate boards, and
17 boards of trade) and exempt from taxation under section
18 501 (a) .

19 “(8) ITEMS AVAILABLE TO PUBLIC.—Expenses for
20 goods, services, and facilities made available by the tax-
21 payer to the general public.

22 “(9) ENTERTAINMENT SOLD TO CUSTOMERS.—Ex-
23 penses for goods or services (including the use of facili-
24 ties) which are sold by the taxpayer in a bona fide

1 transaction for an adequate and full consideration in
2 money or money's worth.

3 For purposes of this subsection, any item referred to in sub-
4 section (a) shall be treated as an expense.

5 “(e) INTEREST, TAXES, CASUALTY LOSSES, ETC.—
6 This section shall not apply to any deduction allowable to
7 the taxpayer without regard to its connection with his trade
8 or business (or with his income-producing activity). In the
9 case of a taxpayer which is not an individual, the preceding
10 sentence shall be applied as if it were an individual.

11 “(f) TREATMENT OF ENTERTAINMENT, ETC., TYPE
12 FACILITY.—For purposes of this chapter, if deductions are
13 disallowed under subsection (a) with respect to any portion
14 of a facility, such portion shall be treated as an asset which is
15 used for personal, living, and family purposes (and not as
16 an asset used in the trade or business).

17 “(g) REGULATORY AUTHORITY.—The Secretary or his
18 delegate shall prescribe such regulations as he may deem
19 necessary to carry out the purposes of this section, includ-
20 ing regulations prescribing whether subsection (a) or sub-
21 section (b) applies in cases where both such subsections
22 would otherwise apply.”

1 (2) The table of sections for such part IX is amended
2 by adding at the end thereof the following:

 “Sec. 274. Disallowance of certain entertainment, etc., ex-
 penses.”

3 (b) TRAVELING EXPENSES.—Section 162 (a) (2) (re-
4 lating to traveling expenses) is amended by striking out
5 “(including the entire amount expended for meals and lodg-
6 ing)” and inserting in lieu thereof “(including a reasonable
7 allowance for amounts expended for meals and lodging)”.

8 (c) EFFECTIVE DATE.—The amendments made by this
9 section shall apply with respect to taxable years ending after
10 June 30, 1962, but only in respect of periods after such
11 date.

12 **SEC. 5. AMOUNT OF DISTRIBUTION WHERE CERTAIN**
13 **FOREIGN CORPORATIONS DISTRIBUTE PROP-**
14 **ERTY IN KIND.**

15 (a) AMOUNT DISTRIBUTED.—Section 301 (b) (1)
16 (relating to amount distributed to corporate distributees) is
17 amended by adding at the end thereof the following new
18 subparagraph:

19 “(C) CERTAIN CORPORATE DISTRIBUTEES OF
20 FOREIGN CORPORATION.—Notwithstanding subpara-
21 graph (B), if the shareholder is a corporation and
22 the distributing corporation is a foreign corporation,
23 the amount taken into account with respect to

property (other than money) shall be the fair market value of such property; except that if any deduction is allowable under section 245 with respect to such distribution, then the amount taken into account shall be the sum (determined under regulations prescribed by the Secretary or his delegate) of—

“(i) the proportion of the adjusted basis of such property (or, if lower, its fair market value) properly attributable to gross income from sources within the United States, and

“(ii) the proportion of the fair market value of such property properly attributable to gross income from sources without the United States.”

(b) BASIS.—Section 301 (d) (relating to basis of property) is amended by adding at the end thereof the following new paragraph:

“(3) CERTAIN CORPORATE DISTRIBUTEES OF FOREIGN CORPORATION.—In the case of property described in subparagraph (C) of subsection (b) (1), the basis shall be determined by substituting the amount determined under such subparagraph (C) for the amount described in paragraph (2) of this subsection.”

1 (c) DIVIDENDS RECEIVED FROM CERTAIN FOREIGN
2 CORPORATIONS.—

3 (1) Section 245 (relating to dividends received
4 from certain foreign corporations) is amended by add-
5 ing at the end thereof the following new subsection:

6 “(b) PROPERTY DISTRIBUTIONS.—For purposes of sub-
7 section (a), the amount of any distribution of property other
8 than money shall be the amount determined by applying
9 section 301 (b) (1) (B).”

10 (2) Section 245 is amended by striking out “In
11 the case of” and inserting in lieu thereof “(a) GENERAL
12 RULE.—In the case of”.

13 (d) CREDIT FOR FOREIGN TAXES.—Section 902 (a)
14 (relating to credit for foreign taxes) is amended by adding
15 at the end thereof the following new sentence: “For pur-
16 poses of this subsection and subsection (b), the amount of
17 any distribution in property other than money shall be the
18 amount determined by applying section 301 (b) (1) (B).”

19 (e) EFFECTIVE DATE.—The amendments made by this
20 section shall apply to distributions made after December 31,
21 1962.

22 SEC. 6. AMENDMENT OF SECTION 482.

23 (a) IN GENERAL.—Section 482 (relating to allocation
24 of income and deductions among taxpayers) is amended
25 by adding at the end thereof the following new subsection:

1 “(b) SALES AND PURCHASES WITHIN A RELATED
2 GROUP WHICH INCLUDES A FOREIGN ORGANIZATION.—

3 “(1) IN GENERAL.—In applying subsection (a)
4 to sales of tangible property within a group of organiza-
5 tions—

6 “(A) owned or controlled directly or indi-
7 rectly by the same interests, and

8 “(B) at least one of which is a domestic or-
9 ganization and at least one of which is a foreign
10 organization,

11 the Secretary or his delegate may allocate the taxable
12 income of the group arising from such sales in the
13 manner set forth in paragraph (2). This subsection
14 shall not apply with respect to any sale of tangible
15 property for which the taxpayer can establish an arm’s
16 length price (within the meaning of paragraph (4)).

17 “(2) METHODS OF ALLOCATION.—

18 “(A) CONSIDERATION OF CERTAIN FAC-
19 TORS.—Except as provided in subparagraph (B),
20 the allocation referred to in paragraph (1) shall be
21 made by the Secretary or his delegate by taking into
22 consideration that portion of the following factors
23 which is attributable to the United States and that
24 portion thereof which is not attributable to the
25 United States—

1 “(i) assets of the group, to the extent used
2 in the production, distribution, and sale of the
3 property,

4 “(ii) compensation of officers and em-
5 ployees, to the extent attributable to the pro-
6 duction, distribution, and sale of the property,
7 and

8 “(iii) advertising, selling, and sales promo-
9 tion expenses (including technical and servic-
10 ing expenses), to the extent attributable to
11 the property.

12 Such method of allocation may also give considera-
13 tion to other factors, including the special risks (if
14 any) of the market in which the property is sold.

15 “(B) ALTERNATIVE METHODS.—If the tax-
16 payer establishes to the satisfaction of the Secretary
17 or his delegate that an alternative method of alloca-
18 tion clearly reflects the income of each member of
19 the group with respect to the property referred to in
20 paragraph (1), such alternative method shall be
21 used (in lieu of the method provided in subpara-
22 graph (A)).

23 “(3) SPECIAL RULES.—In applying the method
24 of allocation referred to in paragraph (2) (A), the
25 following rules shall be applied:

“(A) ADJUSTED BASIS OF ASSETS.—The values to be assigned to the assets referred to in paragraph (2) (A) (i) is their adjusted basis in the hands of the taxpayer or, if such basis is not available in the case of a foreign organization, then their book values, adjusted to approximate their adjusted basis.

“(B) INCLUDIBLE ASSETS.—The assets referred to in paragraph (2) (A) (i) include real property and tangible personal property (whether owned or leased by a member of the group), but do not include inventory and stock in trade.

“(4) ARM’S LENGTH PRICE DEFINED.—For purposes of this subsection, the term ‘arm’s length price’ means—

“(A) the price at which tangible property similar or comparable to the property referred to in paragraph (1) generally is or can be sold in transactions in the same areas involving unrelated persons and made under similar conditions of sale; and

“(B) if subparagraph (A) does not apply, the price at which tangible property similar or comparable to the property referred to in paragraph (1) is sold in the same or other areas under similar circumstances and in transactions involving unre-

1 lated persons, with adjustment for material differ-
2 ences in quantity, marketing conditions (including
3 customs duties and transportation costs), and other
4 relevant factors.

5 Subparagraph (B) shall apply only if the adjustment
6 referred to therein is properly determinable.

7 “(5) SALES COMMISSIONS.—The Secretary or his
8 delegate shall by regulation prescribe rules for the allo-
9 cation of commissions arising from sales of tangible
10 property within a group of organizations described in
11 paragraph (1). Such rules shall be consistent with the
12 principles specified in the other paragraphs of this
13 subsection.

14 “(6) GROSSLY INADEQUATE ASSETS, ETC., OUT-
15 SIDE UNITED STATES.—In allocating taxable income
16 under this subsection, no amount shall be allocated to a
17 foreign organization whose assets, personnel, and office
18 and other facilities which are not attributable to the
19 United States are grossly inadequate for its activities
20 outside the United States.

21 “(7) INFORMATION NECESSARY FOR CONSIDERA-
22 TION OF FACTORS.—In the case of any transaction to
23 which paragraph (2) (A) applies, if—

24 “(A) the information submitted with respect
25 to the group of organizations is insufficient for the

proper application of the method of allocation set forth in the first sentence of such paragraph, and

“(B) upon request of the Secretary or his delegate, such group fails to furnish such additional information with respect to such transaction as may be reasonably supplied,

the Secretary or his delegate may estimate the taxable income arising from such transaction and may allocate such taxable income among the members of the group or to any single member thereof.

“(8) TREATMENT OF FOREIGN TAXES.—

“(A) For purposes of this subsection, taxable income shall be determined without regard to any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States.

“(B) Where the application of this subsection results in a decrease in the taxable income of any foreign organization and an increase in the taxable income of any domestic organization, then any of the taxes referred to in subparagraph (A) paid by such foreign organization and attributable to the taxable income so transferred shall be treated for purposes of this chapter—

1 “(i) as paid by such domestic organiza-
2 tion, and

3 “(ii) as not paid by such foreign organi-
4 zation.”

5 (b) CLERICAL AMENDMENT.—Section 482 is amended
6 by striking out “In any case of two or more organizations”
7 and inserting in lieu thereof the following:

8 “(a) GENERAL RULE.—In the case of two or more
9 organizations”.

10 (c) EFFECTIVE DATE.—The amendments made by
11 this section shall apply with respect to taxable years begin-
12 ning after December 31, 1962.

13 **SEC. 7. DISTRIBUTIONS OF FOREIGN PERSONAL HOLD-**
14 **ING COMPANY INCOME.**

15 (a) DEFINITION OF FOREIGN PERSONAL HOLDING
16 COMPANY.—So much of subsection (a) of section 522 (re-
17 lating to definition of foreign personal holding company) as
18 precedes paragraph (2) is amended to read as follows:

19 “(a) GENERAL RULE.—For purposes of this subtitle,
20 the term ‘foreign personal holding company’ for a taxable
21 year beginning after December 31, 1962, means any for-
22 eign corporation if—

23 “(1) GROSS INCOME REQUIREMENT.—At least 20
24 percent of its gross income (as defined in section 555
25 (a)) for the taxable year is foreign personal holding

company income (as defined in section 553). For purposes of this paragraph, there shall be included in the gross income the amount includible therein as a dividend by reason of the application of section 555 (c) (2) ; and”.

(b) AMOUNT OF UNDISTRIBUTED INCOME.—Subsection (a) of section 556 (relating to undistributed foreign personal holding company income) is amended to read as follows:

“(a) DEFINITION.—For purposes of this part—

“(1) If the foreign personal holding company income of a foreign personal holding company exceeds 80 percent of its gross income, the ‘undistributed foreign personal holding company income’ of such company is its taxable income adjusted in the manner provided in subsection (b), minus the dividends paid deduction (as defined in section 561).

“(2) If the foreign personal holding company income of a foreign personal holding company does not exceed 80 percent of its gross income, the ‘undistributed foreign personal holding company income’ of such company is that amount which bears the same ratio to—

“(A) its taxable income adjusted in the manner provided in subsection (b), minus the dividends paid deduction (as defined in section 561), as

1 “(B) its foreign personal holding company in-
2 come bears to its gross income.”

3 (c) **EFFECTIVE DATE.**—The amendments made by this
4 section shall apply only in respect of taxable years of
5 foreign corporations beginning after December 31, 1962.

6 **SEC. 8. MUTUAL SAVINGS BANKS, ETC.**

7 (a) **RESERVES FOR LOSSES ON LOANS.**—Section 593
8 is amended to read as follows:

9 **“SEC. 593. RESERVES FOR LOSSES ON LOANS.**

10 “(a) **ORGANIZATIONS TO WHICH SECTION APPLIES.**—
11 This section shall apply to any mutual savings bank not
12 having capital stock represented by shares, domestic building
13 and loan association, or cooperative bank without capital
14 stock organized and operated for mutual purposes and with-
15 out profit.

16 “(b) **ADDITION TO RESERVES FOR BAD DEBTS.**—

17 “(1) **IN GENERAL.**—For purposes of section 166
18 (c), the reasonable addition for the taxable year to the
19 reserve for bad debts of any taxpayer described in sub-
20 section (a) shall be an amount equal to the sum of—

21 “(A) the amount determined under section
22 166(c) to be a reasonable addition to the reserve
23 for losses on nonqualifying loans, plus

24 “(B) the amount determined by the taxpayer
25 to be a reasonable addition to the reserve for losses

on qualifying real property loans, but such amount shall not exceed the amount determined under paragraph (2), (3), or (4), whichever amount is the largest.

“(2) 60 PERCENT OF TAXABLE INCOME METHOD.—The amount determined under this paragraph for the taxable year shall be the excess of—

“(A) an amount equal to 60 percent of the taxable income for such year, over

“(B) the amount referred to in paragraph (1) (A) for such year.

For purposes of this paragraph, taxable income shall be computed (i) by excluding from gross income any amount included therein by reason of subsection (f), and (ii) without regard to any deduction allowable for any addition to the reserve for bad debts.

“(3) 3 PERCENT OF REAL PROPERTY LOANS METHOD.—The amount determined under this paragraph for the taxable year shall be an amount equal to the amount necessary to increase the balance (as of the close of the taxable year) of the reserve for losses on qualifying real property loans to 3 percent of such loans outstanding at such time.

“(4) EXPERIENCE METHOD.—The amount determined under this paragraph for the taxable year shall

1 be an amount equal to the amount determined under
2 section 166 (c) (without regard to this subsection) to
3 be a reasonable addition to the reserve for losses on
4 qualifying real property loans.

5 “(c) TREATMENT OF RESERVES FOR BAD DEBTS.—

6 “(1) ESTABLISHMENT OF RESERVES.—Each tax-
7 payer described in subsection (a) which uses the reserve
8 method of accounting for bad debts shall establish and
9 maintain a reserve for losses on qualifying real property
10 loans, a reserve for losses on nonqualifying loans, and a
11 supplemental reserve for losses on loans. For purposes
12 of this title, such reserves shall be treated as reserves
13 for bad debts, but no deduction shall be allowed for any
14 addition to the supplemental reserve for losses on loans.

15 “(2) ALLOCATION OF PRE-1963 RESERVES.—For
16 purposes of this section, the pre-1963 reserves shall, as
17 of the close of December 31, 1962, be allocated to, and
18 constitute the opening balance of—

19 “(A) the reserve for losses on nonqualifying
20 loans,

21 “(B) the reserve for losses on qualifying real
22 property loans, and

23 “(C) the supplemental reserve for losses on
24 loans.

1 “(3) METHOD OF ALLOCATION.—The allocation
2 provided by paragraph (2) shall be made—

3 “(A) first, to the reserve described in para-
4 graph (2) (A), to the extent such reserve is not
5 increased above the amount which would be a
6 reasonable addition under section 166(c) for a
7 period in which the nonqualifying loans increased
8 from zero to the amount thereof outstanding at the
9 close of December 31, 1962;

10 “(B) second, to the reserve described in para-
11 graph (2) (B), to the extent such reserve is not
12 increased above the amount which would be deter-
13 mined under paragraph (3) or (4) of subsection
14 (b) (whichever such amount is the larger) for a
15 period in which the qualifying real property loans
16 increased from zero to the amount thereof outstand-
17 ing at the close of December 31, 1962; and

18 “(C) then to the supplemental reserve for
19 losses on loans.

20 “(4) PRE-1963 RESERVES DEFINED.—For purposes
21 of this subsection, the term ‘pre-1963 reserves’ means
22 the net amount, determined as of the close of December
23 31, 1962 (after applying subsection (d) (1)), accumu-
24 lated in the reserve for bad debts pursuant to section

1 166(c) (or the corresponding provisions of prior reve-
2 nue laws) for taxable years beginning after December
3 31, 1951.

4 “(5) CHARGING OF BAD DEBTS TO RESERVES.—

5 Any debt becoming worthless or partially worthless
6 in respect of a qualifying real property loan shall be
7 charged to the reserve for losses on such loans, and any
8 debt becoming worthless or partially worthless in re-
9 spect of a nonqualifying loan shall be charged to the
10 reserve for losses on nonqualifying loans; except that
11 any such debt may, at the election of the taxpayer, be
12 charged in whole or in part to the supplemental reserve
13 for losses on loans.

14 “(d) TAXABLE YEARS BEGINNING IN 1962 AND END-
15 ING IN 1963.—In the case of a taxable year beginning before
16 January 1, 1963, and ending after December 31, 1962, of
17 a taxpayer described in subsection (a) which uses the
18 reserve method of accounting for bad debts, the taxable in-
19 come shall be the sum of—

20 “(1) that portion of the taxable income allocable
21 to the part of the taxable year occurring before January
22 1, 1963, reduced by the amount of the deduction for an
23 addition to a reserve for bad debts which would be allow-
24 able under section 166(c) (without regard to the

1 amendments made by section 8 of the Revenue Act of
 2 1962) if such part year constituted a taxable year, plus

3 “(2) that portion of the taxable income allocable
 4 to the part of the taxable year occurring after December
 5 31, 1962, reduced by the amount of the deduction for
 6 an addition to a reserve for bad debts which would be
 7 allowed under section 166 (c) (taking into account the
 8 amendments made by section 8 of the Revenue Act of
 9 1962) if such part year constituted a taxable year.

10 For purposes of the preceding sentence, the taxable income
 11 shall be determined without regard to any deduction under
 12 section 166 (c), and the portion thereof allocable to each
 13 part year shall be determined on the basis of the ratio which
 14 the number of days in such part year bears to the number
 15 of days in the entire taxable year.

16 “(e) LOANS DEFINED.—For purposes of this section—

17 “(1) QUALIFYING REAL PROPERTY LOANS.—The
 18 term ‘qualifying real property loan’ means any loan of
 19 the taxpayer secured by an interest in improved real
 20 property, but such term does not include—

21 “(A) any loan evidenced by a security (as de-
 22 fined in section 165 (g) (2) (C)) ;

23 “(B) any loan, whether or not evidenced by a

1 security (as defined in section 165 (g) (2) (C)),
2 the primary obligor on which is—

3 “ (i) a government or political subdivision
4 or instrumentality thereof;

5 “ (ii) a bank (as defined in section 581) ;
6 or

7 “ (iii) another member of the same affil-
8 iated group;

9 “ (C) any loan, to the extent secured by a
10 deposit in or share of the taxpayer; or

11 “ (D) any loan which, within a 60-day period
12 beginning in one taxable year of the creditor and
13 ending in its next taxable year, is made or acquired
14 and then repaid or disposed of, unless the trans-
15 actions by which such loan was made or acquired
16 and then repaid or disposed of are established to be
17 for bona fide business purposes.

18 For purposes of subparagraph (B) (iii), the term
19 ‘affiliated group’ has the meaning assigned to such term
20 by section 1504 (a) ; except that (i) the phrase ‘more
21 than 50 percent’ shall be substituted for the phrase ‘at
22 least 80 percent’ each place it appears in section 1504
23 (a), and (ii) all corporations shall be treated as
24 includible corporations (without any exclusion under
25 section 1504 (b)).

1 “(2) NONQUALIFYING LOANS.—The term ‘non-
2 qualifying loan’ means any loan of the taxpayer which
3 is not a qualifying real property loan.

4 “(3) LOAN.—The term ‘loan’ means debt, as the
5 term ‘debt’ is used in section 166.

6 “(f) DISTRIBUTIONS TO SHAREHOLDERS.—

7 “(1) IN GENERAL.—For purposes of this chapter,
8 any distribution of property (as defined in section 317
9 (a)) by a domestic building and loan association to a
10 shareholder with respect to its stock, if such distribution
11 is not allowable as a deduction under section 591, shall
12 be treated as made—

13 “(A) first out of the reserve for losses on quali-
14 fying real property loans to the extent additions to
15 such reserve exceed the additions which would have
16 been allowed under subsection (b) (4) ,

17 “(B) then out of the supplemental reserve for
18 losses on loans, to the extent thereof,

19 “(C) then out of its earnings and profits ac-
20 cumulated in taxable years beginning after Decem-
21 ber 31, 1951, to the extent thereof, and

22 “(D) then out of such other accounts as may
23 be proper.

24 “(2) AMOUNTS CHARGED TO RESERVE ACCOUNTS
25 AND INCLUDED IN GROSS INCOME.—If any distribution

1 is treated under paragraph (1) as having been made
2 out of the reserves described in subparagraphs (A) and
3 (B) of such paragraph, the amount charged against
4 such reserve shall be the amount which, when reduced
5 by the amount of tax imposed under this chapter and
6 attributable to the inclusion of such amount in gross
7 income, is equal to the amount of such distribution; and
8 the amount so charged against such reserve shall be
9 included in gross income of the taxpayer.

10 “(3) SPECIAL RULES.—

11 “(A) For purposes of paragraph (1) (A),
12 additions to the reserve for losses on qualifying real
13 property loans for the taxable year in which the
14 distribution occurs shall be taken into account.

15 “(B) For purposes of computing under this
16 section the amount of a reasonable addition to the
17 reserve for losses on qualifying real property loans
18 for any taxable year, any amount charged during
19 any year to such reserve pursuant to the provisions
20 of paragraph (2) shall not be taken into account.

21 “(C) For purposes of this subsection, the term
22 ‘distribution’ includes any distribution in redemption
23 of stock or in partial or complete liquidation of the
24 association.”

25 (b) FORECLOSURE ON PROPERTY SECURING LOANS.—

1 Part II of subchapter H of chapter 1 (relating to mutual
2 savings banks, etc.) is amended by adding at the end thereof
3 the following new section:

4 **"SEC. 595. FORECLOSURE ON PROPERTY SECURING LOANS.**

5 " (a) NONRECOGNITION OF GAIN OR LOSS AS A RESULT
6 OF FORECLOSURE.—In the case of a creditor which is an
7 organization described in section 593 (a), no gain or loss
8 shall be recognized, and no debt shall be considered as be-
9 coming worthless or partially worthless, as the result of such
10 organization having bid in at foreclosure, or having otherwise
11 reduced to ownership or possession by agreement or process
12 of law, any property which was security for the payment of
13 any indebtedness.

14 " (b) CHARACTER OF PROPERTY.—For purposes of
15 sections 166 and 1221, any property acquired in a trans-
16 action with respect to which gain or loss to an organization
17 was not recognized by reason of subsection (a) shall be
18 considered as property having the same characteristics as
19 the indebtedness for which such property was security. Any
20 amount realized by such organization with respect to such
21 property shall be treated for purposes of this chapter as a
22 payment on account of such indebtedness, and any loss with
23 respect thereto shall be treated as a bad debt to which the
24 provisions of section 166 (relating to allowance of a deduc-
25 tion for bad debts) apply.

1 “(c) BASIS.—The basis of any property to which sub-
2 section (a) applies shall be the basis of the indebtedness for
3 which such property was security (determined as of the date
4 of the acquisition of such property), properly increased for
5 costs of acquisition.

6 “(d) REGULATORY AUTHORITY.—The Secretary or his
7 delegate shall prescribe such regulations as he may deem
8 necessary to carry out the purposes of this section.”

9 (c) DEFINITION OF DOMESTIC BUILDING AND LOAN
10 ASSOCIATION.—Paragraph (19) of section 7701 (a) (def-
11 inition of domestic building and loan association) is amended
12 to read as follows:

13 “(19) DOMESTIC BUILDING AND LOAN ASSOCIA-
14 TION.—The term ‘domestic building and loan association’
15 means a domestic building and loan association, a do-
16 mestic savings and loan association, and a Federal sav-
17 ings and loan association, which—

18 “(A) is an insured institution (within the
19 meaning of section 401 (a) of the National Housing
20 Act (12 U.S.C., sec. 1724 (a)), or

21 “(B) is subject by law to supervision and
22 examination by State or Federal authority having
23 supervision over such associations,
24 if substantially all of its business consists of accepting
25 savings and investing the proceeds (i) in loans secured

by an interest in real property which is (or, from the proceeds of the loan, will become) residential real property, and (ii) in other loans, to the extent such other loans would be authorized to be made by a Federal savings and loan association under the second paragraph of section 5 (c) of the Home Owners' Loan Act, as amended (12 U.S.C., sec. 1464 (c)).”

(d) CLERICAL AMENDMENTS.—The table of sections for part II of subchapter H of chapter 1 is amended—

(1) by striking out the third item and inserting in lieu thereof the following:

“Sec. 593. Reserves for losses on loans.”

and

(2) by adding at the end thereof the following:

“Sec. 595. Foreclosure on property securing loans.”

(e) REPEAL OF EXEMPTION FROM COMMUNICATIONS AND TRANSPORTATION OF PERSONS TAXES.—Notwithstanding any other provision of law, Federal savings and loan associations shall not be exempt as such from the taxes imposed by section 4251 (relating to excise tax on communications) and section 4261 (relating to excise tax on transportation of persons) of the Internal Revenue Code of 1954.

(f) EFFECTIVE DATES.—

(1) The amendment made by subsection (a) shall

1 apply to taxable years ending after December 31, 1962,
 2 except that section 593 (f) of the Internal Revenue
 3 Code of 1954 shall apply to distributions after Decem-
 4 ber 31, 1962, in taxable years ending after such date.

5 (2) The amendment made by subsection (b) shall
 6 apply to transactions described in section 595 (a) of the
 7 Internal Revenue Code of 1954 occurring after Decem-
 8 ber 31, 1962, in taxable years ending after such date.

9 (3) Subsection (e) of this section shall apply—

10 (A) in the case of the tax imposed by section
 11 4251 of the Internal Revenue Code of 1954, with
 12 respect to amounts paid pursuant to bills rendered
 13 after June 30, 1962; and

14 (B) in the case of the tax imposed by section
 15 4261 of such Code, with respect to transportation
 16 beginning after June 30, 1962.

17 **SEC. 9. DISTRIBUTIONS BY FOREIGN TRUSTS.**

18 (a) **DEFINITIONS.—**

19 (1) **INCOME OF FOREIGN TRUST.**—Section 643 (a)
 20 (6) (relating to modifications taken into account in com-
 21 puting distributable net income) is amended to read as
 22 follows:

23 “(6) **INCOME OF FOREIGN TRUST.**—In the case of
 24 a foreign trust—

25 “(A) There shall be included the amounts of

gross income from sources without the United States, reduced by any amounts which would be deductible in respect of disbursements allocable to such income but for the provisions of section 265 (1) (relating to disallowance of certain deductions).

“(B) Gross income from sources within the United States shall be determined without regard to section 894 (relating to income exempt under treaty).

“(C) Subsection (a) (3) of this section shall not apply to a foreign trust created by a United States person. In the case of such a trust, (i) there shall be included gains from the sale or exchange of capital assets, reduced by losses from such sales or exchanges to the extent such losses do not exceed gains from such sales or exchanges, and (ii) the deduction under section 1202 (relating to deduction for excess of capital gains over capital losses) shall not be taken into account.”

(2) FOREIGN ESTATES AND TRUSTS.—Section 643 (relating to definitions) is amended by adding at the end thereof the following new subsection:

“(d) FOREIGN TRUSTS CREATED BY UNITED STATES PERSONS.—For purposes of this part, the term ‘foreign trust created by a United States person’ means a foreign trust (as

1 defined in section 7701 (a) (31)) to which money or prop-
 2 erty has been transferred directly or indirectly by a United
 3 States person (as defined in section 7701 (a) (30)), or under
 4 the will of a decedent who at the date of his death was a
 5 United States citizen or resident.”

6 (b) ACCUMULATION DISTRIBUTIONS OF FOREIGN
 7 TRUSTS.—

8 (1) Section 665 (b) (relating to definitions
 9 applicable to subpart D) is amended by striking out
 10 “(b) ACCUMULATION DISTRIBUTION.—For purposes
 11 of this subpart,” and inserting in lieu thereof the fol-
 12 lowing:

13 “(b) ACCUMULATION DISTRIBUTIONS OF TRUSTS
 14 OTHER THAN CERTAIN FOREIGN TRUSTS.—For purposes of
 15 this subpart, in the case of a trust (other than a foreign trust
 16 created by a United States person),”.

17 (2) Section 665 is amended by redesignating sub-
 18 sections (c) and (d) as (d) and (e), respectively,
 19 and by inserting after subsection (b) the following
 20 new subsection:

21 “(c) ACCUMULATION DISTRIBUTION OF CERTAIN
 22 FOREIGN TRUSTS.—For purposes of this subpart, in the case
 23 of a foreign trust created by a United States person, the term
 24 ‘accumulation distribution’ for any taxable year of the trust
 25 means the amount by which the amounts specified in para-

graph (2) of section 661 (a) for such taxable year exceed distributable net income, reduced by the amounts specified in paragraph (1) of section 661 (a). For purposes of this subsection, the amount specified in paragraph (2) of section 661 (a) shall be determined without regard to section 666. Any amount paid to a United States person which is from a payor who is not a United States person and which is derived directly or indirectly from a foreign trust created by a United States person shall be deemed in the year of payment to have been directly paid by the foreign trust.”

(c) ALLOCATION OF ACCUMULATION DISTRIBUTIONS TO PRECEDING YEARS.—Section 666 (a) (relating to accumulation distribution allocated to 5 preceding years) is amended—

(1) by striking out “(a) AMOUNT ALLOCATED.—In the case of a trust” and inserting in lieu thereof the following:

“(a) AMOUNT ALLOCATED.—In the case of a trust (other than a foreign trust created by a United States person)”; and

(2) by adding at the end thereof the following new sentence:

“In the case of a foreign trust created by a United States person, this subsection shall apply to the preceding taxable years of the trust without regard to any provision of

1 the preceding sentences which would (but for this sentence)
 2 limit its application to the 5 preceding taxable years.”

3 (d) AMOUNTS TREATED AS RECEIVED IN PRIOR
 4 YEARS.—Section 668 (a) (relating to amounts treated as
 5 received in prior taxable years) is amended by adding at
 6 the end thereof the following new sentence: “Except as
 7 provided in section 669, in the case of a foreign trust created
 8 by a United States person the preceding sentence shall not
 9 apply to any beneficiary who is a United States person.”

10 (e) SPECIAL RULES FOR FOREIGN TRUSTS.—Subpart
 11 D of part I of subchapter J of chapter 1 (relating to treat-
 12 ment of excess distributions by trusts) is amended by adding
 13 at the end thereof the following new section:

14 “SEC. 669. SPECIAL RULES APPLICABLE TO CERTAIN FOR-
 15 EIGN TRUSTS.

16 “(a) LIMITATION ON TAX.—

17 “(1) GENERAL RULE.—At the election of a bene-
 18 ficiary who is a United States person (as defined in
 19 section 7701 (a) (30)) and who satisfies the require-
 20 ments of subsection (b), the tax attributable to the
 21 amounts treated under section 668 (a) as having been
 22 received by him from a foreign trust created by a United
 23 States person on the last day of a preceding taxable
 24 year of the trust shall not be greater than—

1 “(A) the tax determined under the next to the
2 last sentence of section 668 (a), or

3 “(B) the tax determined by multiplying by
4 the number of preceding taxable years of the trust,
5 on the last day of each of which an amount is
6 deemed under section 666 (a) to have been distrib-
7 uted, the average of the increase in tax attributable
8 to recomputing the beneficiary’s gross income for the
9 taxable year and each of his 2 taxable years imme-
10 diately preceding the year of the accumulation dis-
11 tribution by adding to the income of each of such
12 years an amount determined by dividing the amount
13 required to be included in income under section
14 668 (a) by such number of preceding taxable years
15 of the trust. The recomputation for the taxable year
16 shall be made without regard to the inclusion in
17 income required by section 668 (a) of any amount
18 other than pursuant to this paragraph.

19 “(2) EXCEPTIONS.—

20 “(A) When an accumulation distribution is
21 deemed under section 666 (a) to have been distrib-
22 uted on the last day of less than 3 taxable years
23 of the trust, the taxable years of the beneficiary for
24 which a recomputation is made under subsection

1 (a) (1) (B) shall equal the number of years to
2 which section 666 (a) applies, commencing with
3 the most recent taxable year of the beneficiary.

4 “(B) If a beneficiary was not alive on the last
5 day of each preceding taxable year of the trust
6 with respect to which a distribution is deemed made
7 under section 666 (a), paragraph (1) (A) of this
8 subsection shall not apply. In applying paragraph
9 (1) (B) of this subsection, no recomputation shall
10 be made for a beneficiary for a taxable year for
11 which he was not alive; if he has no preceding tax-
12 able year, the recomputation shall be made on the
13 basis of his taxable year without regard to the in-
14 clusion in income required by section 668 (a) of
15 any amount other than pursuant to paragraph
16 (1) (B).

17 “(3) EFFECT OF PRIOR ELECTION.—In comput-
18 ing the limitation on tax under paragraph (1) of this
19 subsection for any beneficiary—

20 “(A) SUBSEQUENT ELECTION UNDER PARA-
21 GRAPH (1)(A).—If an election has been made under
22 paragraph (1) (B) of this subsection, for purposes
23 of a subsequent election under paragraph (1) (A)
24 the income of any year with respect to which an

1 amount is deemed distributed to a beneficiary under
2 section 666 (a) shall include amounts previously
3 deemed distributed to such beneficiary for such
4 year as a result of an accumulation distribution with
5 respect to which an election under paragraph (1)
6 (B) was made.

7 “(B) SUBSEQUENT ELECTION UNDER PARA-
8 GRAPH (1)(B).—If with respect to an accumulation
9 distribution an election has been made under either
10 paragraph (1) (A) or paragraph (1) (B) of this
11 subsection, or the next to the last sentence of section
12 668 (a) has applied, for purposes of a subsequent
13 election under paragraph (1) (B) the number of
14 preceding taxable years of the trust with respect to
15 which an amount is deemed distributed to a benefi-
16 ciary under section 666 (a) shall be determined
17 without regard to any such year with respect to
18 which an amount was previously deemed distrib-
19 uted to such beneficiary.

20 “(b) INFORMATION REQUIREMENT.—The election of
21 a beneficiary to apply the limitations on tax provided in sub-
22 section (a) of this section shall not be effective unless the
23 beneficiary at the time of making the election supplies such
24 information with respect to the operation and accounts of the

1 trust, for each taxable year on the last day of which an
2 amount is deemed distributed under section 666 (a), as the
3 Secretary or his delegate may by regulations prescribe.”

4 (f) INFORMATION RETURNS WITH RESPECT TO FOR-
5 EIGN TRUSTS.—Subpart B of part III of subchapter A of
6 chapter 61 (relating to information concerning transactions
7 with other persons) is amended by adding at the end thereof
8 the following new section:

9 “SEC. 6047. RETURNS AS TO CREATION OF OR TRANSFERS
10 TO CERTAIN FOREIGN TRUSTS.

11 “(a) GENERAL RULE.—On or before the 90th day
12 after—

13 “(1) the creation of any foreign trust by a United
14 States person, or

15 “(2) the transfer of any money or property to a
16 foreign trust by a United States person,

17 the grantor in the case of an inter vivos trust, the fiduciary
18 of an estate in the case of a testamentary trust, or the trans-
19 feror, as the case may be, shall make a return in compliance
20 with the provisions of subsection (b).

21 “(b) FORM AND CONTENTS OF RETURNS.—The re-
22 turns required by subsection (a) shall be in such form and
23 shall set forth, in respect of the foreign trust, such informa-
24 tion as the Secretary or his delegate prescribes by regulation

1 as necessary for carrying out the provisions of the income
2 tax laws.

3 “(c) CROSS REFERENCES.—

“ (1) For provisions relating to penalties for violations
of this section, see sections 6677 and 7203.

“ (2) For definition of the term ‘foreign trust created
by a United States person’, see section 643(d).”

4 (g) FAILURE TO FILE INFORMATION RETURNS.—

5 Subchapter B of chapter 68 (relating to assessable penalties)
6 is amended by adding at the end thereof the following new
7 section:

8 “SEC. 6677. FAILURE TO FILE INFORMATION RETURNS
9 WITH RESPECT TO CERTAIN FOREIGN
10 TRUSTS.

11 “(a) CIVIL PENALTY.—In addition to any criminal
12 penalty provided by law, any person required to file a return
13 under section 6047 who fails to file such return at the time
14 provided in such section, or who files a return which does not
15 show the information required pursuant to such section, shall
16 pay a penalty equal to 5 percent of the amount transferred
17 to a trust, but not more than \$1,000, unless it is shown that
18 such failure is due to reasonable cause.

19 “(b) DEFICIENCY PROCEDURES NOT TO APPLY.—

20 Subchapter B of chapter 63 (relating to deficiency proce-
21 dures for income, estate, and gift taxes) shall not apply in

1 respect of the assessment or collection of any penalty
2 imposed by subsection (a).”

3 (h) UNITED STATES PERSON DEFINED.—Section
4 7701 (a) is amended by adding at the end thereof the
5 following new paragraphs:

6 “(30) UNITED STATES PERSON.—The term
7 ‘United States person’ means—

8 “(A) a citizen or resident of the United States,

9 “(B) a domestic partnership,

10 “(C) a domestic corporation, and

11 “(D) any estate or trust (other than a foreign
12 estate or foreign trust, within the meaning of sec-
13 tion 7701 (a) (31)).

14 “(31) FOREIGN ESTATE OR TRUST.—The terms
15 ‘foreign estate’ and ‘foreign trust’ mean an estate or
16 trust, as the case may be, the income of which from
17 sources without the United States is not includible in
18 gross income under subtitle A.”

19 (i) TECHNICAL AMENDMENTS.—

20 (1) The table of sections for subpart D of sub-
21 chapter J of chapter 1 (relating to treatment of excess

distributions by trusts) is amended by adding at the end thereof

“Sec. 669. Special rules applicable to certain foreign trusts.”

(2) The table of sections for subpart B of part III of subchapter A of chapter 61 (relating to information concerning transactions with other persons) is amended by adding at the end thereof

“Sec. 6047. Returns as to creation of or transfers to certain foreign trusts.”

(3) The table of sections for subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof

“Sec. 6677. Failure to file information returns with respect to certain foreign trusts.”

(j) **EFFECTIVE DATE.**—The amendments made by this section (other than by subsections (f), (g), and (h)) shall apply with respect to distributions made in taxable years of trusts beginning after the date of the enactment of this Act.

SEC. 10. MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE, MARINE, AND CERTAIN FIRE INSURANCE COMPANIES), ETC.

(a) **IMPOSITION OF TAX.**—So much of part II of subchapter L (relating to mutual insurance companies, other than life or marine or fire insurance companies issuing per-

petual policies) of chapter 1 as precedes section 822 is amended to read as follows:

**“PART II—MUTUAL INSURANCE COMPANIES
(OTHER THAN LIFE AND CERTAIN
MARINE INSURANCE COMPANIES
AND OTHER THAN FIRE INSURANCE
COMPANIES WHICH OPERATE ON
BASIS OF PERPETUAL POLICIES OR
PREMIUM DEPOSITS)**

“Sec. 821. Tax on mutual insurance companies to which part II applies.

“Sec. 822. Determination of taxable investment income.

“Sec. 823. Determination of statutory underwriting income or loss.

“Sec. 824. Adjustments to provide protection against losses.

“Sec. 825. Unused loss deduction.

“Sec. 826. Election by reciprocal.

“SEC. 821. TAX ON MUTUAL INSURANCE COMPANIES TO WHICH PART II APPLIES.

“(a) IMPOSITION OF TAX.—A tax is hereby imposed for each taxable year beginning after December 31, 1962, on the mutual insurance company taxable income of every mutual insurance company (other than a life insurance company and other than a fire or marine insurance company subject to the tax imposed by section 831). Such tax shall consist of—

“(1) NORMAL TAX.—A normal tax of 25 percent of the mutual insurance company taxable income, or

50 percent of the amount by which such taxable income exceeds \$6,000, whichever is the lesser; plus

“(2) SURTAX.—A surtax of 22 percent of the mutual insurance company taxable income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) in excess of \$25,000.

“(b) MUTUAL INSURANCE COMPANY TAXABLE INCOME DEFINED.—For purposes of this part, the term ‘mutual insurance company taxable income’ means, with respect to any taxable year, the amount by which—

“(1) the sum of—

“(A) the taxable investment income (as defined in section 822 (a) (1)),

“(B) the statutory underwriting income (as defined in section 823 (a) (1)), and

“(C) the amounts required by section 824 (d) to be subtracted from the protection against loss account, exceeds

“(2) the sum of—

“(A) the investment loss (as defined in section 822 (a) (2)),

“(B) the statutory underwriting loss (as defined in section 823 (a) (2)), and

1 “(C) the unused loss deduction provided by
2 section 825 (a) .

3 “(c) ALTERNATIVE TAX FOR CERTAIN SMALL COM-
4 PANIES.—

5 “(1) IMPOSITION OF TAX.—In the case of taxable
6 years beginning after December 31, 1962, there is here-
7 by imposed for each taxable year on the income of each
8 mutual insurance company to which this subsection
9 applies a tax (which shall be in lieu of the tax imposed
10 by subsection (a)) computed as follows:

11 “(A) NORMAL TAX.—A normal tax of 25
12 percent of the taxable investment income, or 50
13 percent of the amount by which such taxable in-
14 come exceeds \$3,000, whichever is the lesser; plus

15 “(B) SURTAX.—A surtax of 22 percent of the
16 taxable investment income (computed without re-
17 gard to the deduction provided in section 242 for
18 partially tax-exempt interest) in excess of \$25,000.

19 “(2) GROSS AMOUNT RECEIVED, OVER \$75,000
20 BUT LESS THAN \$125,000.—If the gross amount re-
21 ceived during the taxable year from the items described
22 in section 822 (b) (other than paragraph (1) (D)
23 thereof) and premiums (including deposits and as-
24 sessments) is over \$75,000 but less than \$125,000, the
25 tax imposed by paragraph (1) shall be reduced to an

1 amount which bears the same proportion to the amount
2 of the tax determined under paragraph (1) as the
3 excess over \$75,000 of such gross amount received bears
4 to \$50,000.

5 “(3) COMPANIES TO WHICH SUBSECTION AP-
6 PLIES.—

7 “(A) IN GENERAL.—Except as provided in
8 subparagraph (B), this subsection shall apply to
9 every mutual insurance company (other than a life
10 insurance company and other than a fire or marine
11 insurance company subject to the tax imposed by
12 section 831) which received during the taxable year
13 from the items described in section 822 (b) (other
14 than paragraph (1) (D) thereof) and premiums
15 (including deposits and assessments) a gross
16 amount in excess of \$75,000 but not in excess of
17 \$300,000.

18 “(B) EXCEPTIONS.—This subsection shall not
19 apply to a mutual insurance company for the tax-
20 able year if—

21 “(i) there is in effect an election by such
22 company made under subsection (d) to be tax-
23 able under subsection (a) ; or

24 “(ii) there is any amount in the protection

1 against loss account at the beginning of the
2 taxable year.

3 “(d) ELECTION TO INCLUDE STATUTORY UNDER-
4 WRITING INCOME OR LOSS.—

5 “(1) IN GENERAL.—Any mutual insurance com-
6 pany which is subject to the tax imposed by subsection
7 (c) may elect, in such manner and at such time as the
8 Secretary or his delegate may by regulations prescribe,
9 to be subject to the tax imposed by subsection (a).

10 “(2) EFFECT OF ELECTION.—If an election is made
11 under paragraph (1), the electing company shall be
12 subject to the tax imposed by subsection (a) (and shall
13 not be subject to the tax imposed by subsection (c))
14 for the first taxable year for which such election is made
15 and for all taxable years thereafter unless the Secretary
16 or his delegate consents to a revocation of such election.

17 “(e) NO UNITED STATES INSURANCE BUSINESS.—
18 Foreign mutual insurance companies (other than a life
19 insurance company and other than a fire or marine insurance
20 company subject to the tax imposed by section 831) not
21 carrying on an insurance business within the United States
22 shall not be subject to this part but shall be taxable as other
23 foreign corporations.

1 “(f) CROSS REFERENCES.—

 “(1) For exemption from tax of certain mutual insurance companies, see section 501(c)(15).

 “(2) For alternative tax in case of capital gains, see section 1201(a).”

2 (b) TAXABLE INVESTMENT INCOME.—

3 (1) IN GENERAL.—Section 822 (relating to de-
4 termination of mutual insurance company taxable
5 income) is amended by striking out the heading and sub-
6 section (a) and inserting in lieu thereof the following:

7 “SEC. 822. DETERMINATION OF TAXABLE INVESTMENT
8 INCOME.

9 “(a) DEFINITIONS.—For purposes of this part—

10 “(1) The term ‘taxable investment income’ means
11 the gross investment income, minus the deductions pro-
12 vided in subsection (c).

13 “(2) The term ‘investment loss’ means the amount
14 by which the deductions provided in subsection (c)
15 exceed the gross investment income.”

16 (2) CONFORMING AMENDMENTS.—Subsections (c)
17 and (e) of section 822 are each amended by striking
18 out “mutual insurance company taxable income” each
19 place it appears and inserting in lieu thereof “taxable
20 investment income”.

1 (3) DIVIDENDS RECEIVED DEDUCTION.—Section
 2 822 (c) (7) (relating to special deductions) is amended
 3 by adding at the end thereof the following new sentence:
 4 “In applying section 246 (b) (relating to limitation on
 5 aggregate amount of deductions for dividends received)
 6 for purposes of this paragraph, the reference in such
 7 section to ‘taxable income’ shall be treated as a reference
 8 to ‘taxable investment income’.”

9 (4) REDESIGNATION OF SECTION 823.—Part II of
 10 subchapter L of chapter 1 is amended by striking out
 11 “SEC. 823. OTHER DEFINITIONS.

12 “‘For purposes of this part—”,
 13 and inserting in lieu thereof (at the end of section 822)
 14 the following:

15 “(f) DEFINITIONS.—For purposes of this part—”.

16 (c) STATUTORY UNDERWRITING INCOME OR LOSS.—
 17 Part II of subchapter L of chapter 1 is amended by adding
 18 after section 822 (f) (as redesignated by subsection (b) (4)
 19 of this section) the following new sections:

20 “SEC. 823. DETERMINATION OF STATUTORY UNDERWRIT-
 21 ING INCOME OR LOSS.

22 “(a) IN GENERAL.—For purposes of this part—

23 “(1) The term ‘statutory underwriting income’
 24 means the amount by which—

25 “(A) the gross income which would be taken

1 into account in computing taxable income under
 2 section 832 if the taxpayer were subject to the tax
 3 imposed by section 831, reduced by the gross in-
 4 vestment income, exceeds

5 “(B) the sum of (i) the deductions which
 6 would be taken into account in computing taxable
 7 income if the taxpayer were subject to the tax im-
 8 posed by section 831, reduced by the deductions
 9 provided in section 822 (c), plus (ii) the deductions
 10 provided in subsection (c) and section 824 (a).

11 “(2) The term ‘statutory underwriting loss’ means
 12 the excess of the amount referred to in paragraph
 13 (1) (B) over the amount referred to in paragraph
 14 (1) (A).

15 “(b) MODIFICATIONS.—In applying subsection (a)—

16 “(1) NET OPERATING LOSS DEDUCTION.—The de-
 17 duction for net operating losses provided in section 172
 18 shall not be allowed.

19 “(2) INTERINSURERS.—In the case of a mutual in-
 20 surance company which is an interinsurer or reciprocal
 21 underwriter—

22 “(A) there shall be allowed as a deduction the
 23 increase for the taxable year in savings credited to
 24 subscriber accounts, or

25 “(B) there shall be included as an item of

1 gross income the decrease for the taxable year in
2 savings credited to subscriber accounts.

3 For purposes of the preceding sentence, the term ‘sav-
4 ings credited to subscriber accounts’ means such portion
5 of the surplus as is credited to the individual accounts
6 of subscribers before the 16th day of the third month
7 following the close of the taxable year, but only if the
8 company would be obligated to pay such amount
9 promptly to such subscriber if he terminated his con-
10 tract at the close of the company’s taxable year. For
11 purposes of determining his taxable income, the sub-
12 scriber shall treat any such savings credited to his ac-
13 count as a dividend paid or declared.

14 “(c) SPECIAL DEDUCTION FOR SMALL COMPANY
15 HAVING GROSS AMOUNT OF LESS THAN \$900,000.—

16 “(1) IN GENERAL.—If the gross amount received
17 during the taxable year by a taxpayer subject to the tax
18 imposed by section 821 (a) from the items described
19 in section 822 (b) (other than paragraph (1) (D)
20 thereof) and premiums (including deposits and assess-
21 ments) does not equal or exceed \$900,000, then in
22 determining the statutory underwriting income or loss
23 for the taxable year there shall be allowed an additional
24 deduction of \$6,000; except that if such gross amount

1 exceeds \$300,000, such additional deduction shall be
2 equal to 1 percent of the amount by which \$900,000
3 exceeds such gross amount.

4 “(2) LIMITATION.—The amount of the deduction
5 allowed under paragraph (1) shall not exceed the
6 statutory underwriting income for the taxable year,
7 computed without regard to any deduction under this
8 subsection or section 824 (a) .

9 “SEC. 824. ADJUSTMENTS TO PROVIDE PROTECTION
10 AGAINST LOSSES.

11 “(a) ALLOWANCE OF DEDUCTION.—

12 “(1) IN GENERAL.—In determining the statutory
13 underwriting income or loss for any taxable year there
14 shall be allowed as a deduction the sum of—

15 “(A) an amount equal to 1 percent of the losses
16 incurred during the taxable year (as determined
17 under section 832 (b) (5)), plus

18 “(B) an amount equal to 25 percent of the
19 underwriting gain for the taxable year, plus

20 “(C) if the concentrated windstorm, etc., pre-
21 mium percentage for the taxable year exceeds 50
22 percent, an amount determined by applying so much
23 of such percentage as exceeds 50 percent to the
24 underwriting gain for the taxable year.

1 For purposes of this paragraph, the term ‘under-
 2 writing gain’ means statutory underwriting income, com-
 3 puted without any deduction under this subsection.

4 “(2) SPECIAL RULE FOR COMPANIES HAVING CON-
 5 CENTRATED WINDSTORM, ETC., RISKS.—For purposes
 6 of paragraph (1) (C), the term ‘concentrated wind-
 7 storm, etc., premium percentage’ means, with respect to
 8 any taxable year, the percentage obtained by dividing—

9 “(A) the amount of the premiums earned
 10 on insurance contracts during the taxable year (as
 11 defined in section 832 (b) (4)), to the extent at-
 12 tributable to insuring against losses arising in any
 13 one State from windstorm, hail, flood, earthquake,
 14 or similar hazards, by

15 “(B) the amount of the premiums earned
 16 on insurance contracts during the taxable year (as
 17 so defined).

18 “(b) PROTECTION AGAINST LOSS ACCOUNT.—Each
 19 insurance company subject to the tax imposed by section
 20 821 (a) for any taxable year shall, for purposes of this part,
 21 establish and maintain a protection against loss account.

22 “(c) ADDITIONS TO ACCOUNT.—There shall be added
 23 to the protection against loss account for each taxable year
 24 an amount equal to the amount allowable as a deduction for
 25 the taxable year under subsection (a) (1).

1 “(d) SUBTRACTIONS.—

2 “(1) ANNUAL SUBTRACTIONS.—After applying
3 subsection (c), there shall be subtracted for the taxable
4 year from the protection against loss account—

5 “(A) first, an amount equal to the excess of
6 the statutory underwriting loss for the taxable year
7 over the underwriting loss (as defined in paragraph
8 (6)) for the taxable year,

9 “(B) then, the amount (if any) by which—

10 “(i) the sum of the investment loss for
11 such year and the underwriting loss for such
12 year, exceeds

13 “(ii) the sum of the statutory underwrit-
14 ing income for such taxable year and the taxable
15 investment income for such taxable year,

16 “(C) next (in the order in which the losses
17 occurred), amounts equal to the unused loss carry-
18 overs to such year,

19 “(D) next, any amount remaining which was
20 added to the account for the fifth preceding taxable
21 year, minus one-half of the amount remaining in the
22 account for such taxable year which was added
23 by reason of subsection (a) (1) (B), and

24 “(E) finally, the amount by which the total

1 amount in the account exceeds whichever of the
2 following is the greater:

3 “(i) 10 percent of premiums earned on in-
4 surance contracts during the taxable year (as
5 defined in section 832 (b) (4)) less dividends
6 to policyholders (as defined in section
7 832 (c) (11)), or

8 “(ii) the total amount in the account at
9 the close of the preceding taxable year.

10 “(2) RULES FOR CEILING ON PROTECTION AGAINST
11 LOSS ACCOUNT.—For purposes of paragraph (1) (E),
12 the total amount in the account shall be determined—

13 “(A) after the application of this section with-
14 out regard to paragraph (1) (E), and

15 “(B) without taking into consideration amounts
16 remaining in the account which were added, with re-
17 spect to all taxable years, by reason of subsection
18 (a) (1) (C).

19 “(3) PRIORITIES.—The amounts required to be
20 subtracted from the protection against loss account—

21 “(A) under subparagraphs (A), (B), and
22 (C) of paragraph (1) shall be subtracted—

23 “(i) first (on a first-in, first-out, basis)
24 from amounts in the account with respect to

1 the five preceding taxable years and the taxable
2 year, and

3 “(ii) then from amounts in the account
4 with respect to earlier years,

5 “(B) under subparagraph (E) of paragraph
6 (1) shall be subtracted only from amounts in the
7 account with respect to the taxable year, and

8 “(C) under paragraphs (A), (B), (C), and
9 (E) of paragraph (1) shall, if the amount to be
10 subtracted from the total amounts in the account
11 with respect to any taxable year is less than such
12 total, be subtracted from each of the amounts (re-
13 ferred to in subsection (a) (1)) in the account with
14 respect to such year in the proportion which each
15 bears to such total.

16 “(4) TERMINATION OF TAXABILITY UNDER SEC-
17 TION 821.—If the taxpayer is not subject to tax under
18 section 821 for any taxable year, the entire amount in
19 the account at the close of the preceding taxable year
20 shall be subtracted from the account in such preceding
21 taxable year.

22 “(5) ELECTION TO SUBTRACT AMOUNT FROM
23 ACCOUNT.—

1 “(A) A taxpayer may elect for any taxable
2 year for which it is subject to tax under section
3 821 (a) to subtract from its protection against loss
4 account any amount which, but for the application of
5 this subparagraph, would be in such account as of
6 the close of such taxable year.

7 “(B) The election provided by subparagraph
8 (A) for any taxable year shall be made (in such
9 manner and in such form as the Secretary or his
10 delegate may by regulations prescribe) after the
11 close of such taxable year and not later than the time
12 prescribed by law for filing the return (including
13 extensions thereof) for the taxable year following
14 such taxable year. Such an election, once made,
15 may not be revoked.

16 “(6) UNDERWRITING LOSS DEFINED.—For pur-
17 poses of paragraph (1), the term ‘underwriting loss’
18 means the amount by which—

19 “(A) the deductions which would be taken
20 into account in computing taxable income under
21 section 832 if the taxpayer were subject to the tax
22 imposed by section 831, reduced by the sum of (i)
23 the deductions provided in section 822 (c), and (ii)
24 the deduction for dividends to policyholders pro-
25 vided by section 832 (c) (11), exceeds

1 “(B) the amount referred to in section 823
2 (a) (1) (A).

3 **“SEC. 825. UNUSED LOSS DEDUCTION.**

4 “(a) **AMOUNT OF DEDUCTION.**—For purposes of this
5 part, the unused loss deduction for the taxable year shall be
6 an amount equal to the unused loss carryovers or carrybacks
7 to the taxable year.

8 “(b) **UNUSED LOSS DEFINED.**—For purposes of this
9 part, the term ‘unused loss’ means, with respect to any tax-
10 able year, the amount (if any) by which—

11 “(1) the sum of the statutory underwriting loss
12 and the investment loss, exceeds

13 “(2) the sum of—

14 “(A) the taxable investment income,

15 “(B) the statutory underwriting income, and

16 “(C) the amounts required by section 824 (d)
17 to be subtracted from the protection against loss
18 account.

19 “(c) **LOSS YEAR DEFINED.**—For purposes of this part,
20 the term ‘loss year’ means, with respect to any company
21 subject to the tax imposed by section 821 (a), any tax-
22 able year in which the unused loss (as defined in subsection
23 (b)) of such taxpayer is more than zero.

24 “(d) **YEARS TO WHICH CARRIED.**—The unused loss
25 for any loss year shall be—

1 “(1) an unused loss carryback to each of the 3
2 taxable years preceding the loss year, and

3 “(2) an unused loss carryover to each of the 5
4 taxable years following the loss year.

5 “(e) AMOUNT OF CARRYBACKS AND CARRYOVERS.—
6 The entire amount of the unused loss for any loss year shall
7 be carried to the earliest of the taxable years to which such
8 loss may be carried. The portion of such loss which shall
9 be carried to each of the other taxable years shall be the
10 excess (if any) of the amount of such loss over the sum
11 of the offsets (as defined in subsection (f)) for each of the
12 prior taxable years to which such loss may be carried.

13 “(f) OFFSET DEFINED.—For purposes of subsection
14 (e), the term ‘offset’ means with respect to any taxable year
15 (hereinafter referred to as the ‘offset year’) —

16 “(1) in the case of an unused loss carryback from
17 the loss year to the offset year, the mutual insurance
18 company taxable income for the offset year; or

19 “(2) in the case of an unused loss carryover from
20 the loss year to the offset year, an amount equal to the
21 sum of—

22 “(A) the amount required to be subtracted
23 from the protection against loss account under sec-
24 tion 824 (d) (1) (C) for the offset year, plus

1 “(B) the mutual insurance company taxable
2 income for the offset year.

3 For purposes of paragraphs (1) and (2) (B), the mutual
4 insurance taxable income for the offset year shall be deter-
5 mined without regard to any unused loss carryback or carry-
6 over from the loss year or any taxable year thereafter.

7 “(g) LIMITATIONS.—For purposes of this part, an un-
8 used loss shall not be carried—

9 “(1) to or from any taxable year beginning before
10 January 1, 1963,

11 “(2) to or from any taxable year for which the
12 insurance company is not subject to the tax imposed by
13 section 821 (a), nor

14 “(3) to any taxable year if, between the loss year
15 and such taxable year, there is an intervening taxable
16 year for which the insurance company was not subject
17 to the tax imposed by section 821 (a).

18 **“SEC. 826. ELECTION BY RECIPROCAL.**

19 “(a) IN GENERAL.—Except as otherwise provided in
20 this section, any mutual insurance company which is an
21 interinsurer or reciprocal underwriter (hereinafter in this
22 section referred to as a ‘reciprocal’) subject to the taxes im-
23 posed by section 821 (a) may, under regulations prescribed
24 by the Secretary or his delegate, elect to be subject to the

1 limitation provided in subsection (b). Such election shall
2 be effective for the taxable year for which made and for all
3 succeeding taxable years, and shall not be revoked except
4 with the consent of the Secretary or his delegate.

5 “(b) LIMITATION.—The deduction for amounts paid or
6 incurred in the taxable year to the attorney-in-fact by a
7 reciprocal making the election provided in subsection (a)
8 shall be limited to, but in no case increased by, the deductions
9 of the attorney-in-fact allocable, in accordance with regula-
10 tions prescribed by the Secretary or his delegate, to the
11 income received by the attorney-in-fact from the reciprocal.

12 “(c) EXCEPTION.—An election may not be made by a
13 reciprocal under subsection (a) unless the attorney-in-fact
14 of such reciprocal—

15 “(1) is subject to the taxes imposed by section 11
16 (b) and (c) ;

17 “(2) consents in such manner as the Secretary or
18 his delegate shall prescribe by regulations to make
19 available such information as may be required during the
20 period in which the election provided in subsection (a)
21 is in effect, under regulations prescribed by the Secretary
22 or his delegate;

23 “(3) reports the income received from the recip-

cal and the deductions allocable thereto under the same method of accounting under which the reciprocal reports deductions for amounts paid to the attorney-in-fact; and

“(4) files its return on the calendar year basis.

“(d) SPECIAL RULE.—For purposes of computing the deduction provided in section 824 (a) and the additions to the account provided by section 824 (c) with respect to any reciprocal electing to be subject to the limitation provided in subsection (b), such limitation shall not be taken into account.

“(e) CREDIT.—Any reciprocal electing to be subject to the limitation provided in subsection (b) shall be credited with so much of the tax paid by the attorney-in-fact as is attributable, under regulations prescribed by the Secretary or his delegate, to the income received by the attorney-in-fact from the reciprocal in such taxable year.

“(f) SURTAX EXEMPTION DENIED.—Any increase in taxable income of a reciprocal attributable to the limitation provided in subsection (b) shall be taxed without regard to the surtax exemption provided in section 821 (a) (2).

“(g) ADJUSTMENT FOR REFUND.—If for any taxable year an attorney-in-fact is allowed a credit or refund for taxes paid with respect to which a reciprocal was allowed

1 a credit under subsection (e), the taxes of such reciprocal
 2 for such taxable year shall be properly adjusted under regu-
 3 lations prescribed by the Secretary or his delegate.

4 “(h) TAXES OF ATTORNEY-IN-FACT UNAFFECTED.—
 5 Nothing in this section shall increase or decrease the taxes
 6 imposed by this chapter on the income of the attorney-in-
 7 fact.”

8 (d) MUTUAL FIRE INSURANCE COMPANIES OPERAT-
 9 ING ON BASIS OF PREMIUM DEPOSITS.—

10 (1) APPLICATION OF SECTION 831(a).—Section
 11 831 (a) (imposing a tax on certain mutual marine and
 12 fire insurance companies and on stock insurance com-
 13 panies which are not life insurance companies) is
 14 amended to read as follows:

15 “(a) IMPOSITION OF TAX.—Taxes computed as pro-
 16 vided in section 11 shall be imposed for each taxable year or
 17 the taxable income of—

18 “(1) every insurance company (other than a life
 19 or mutual insurance company),

20 “(2) every mutual marine insurance company, and

21 “(3) every mutual fire insurance company—

22 “(A) exclusively issuing perpetual policies, or

23 “(B) whose principal business is the issuance
 24 of policies for which the premium deposits are the
 25 same, regardless of the length of the term for which

1 the policies are written, if the unabsorbed portion
2 of such premium deposits not required for losses,
3 expenses, or establishment of reserves is returned or
4 credited to the policyholder on cancellation or ex-
5 piration of the policy.”

6 (2) TREATMENT OF UNABSORBED PREMIUM DE-
7 POSITS.—Section 832 (b) (4) (relating to definition of
8 premiums earned) is amended by adding at the end
9 thereof the following new sentence: “For purposes of
10 this subsection, unearned premiums of mutual fire in-
11 surance companies described in section 831 (a) (3) (B)
12 means (with respect to the policies described in section
13 831 (a) (3) (B) the amount of unabsorbed premium
14 deposits which the company would be obligated to re-
15 turn to its policyholders at the close of the taxable year
16 if all of its policies were terminated at such time; and
17 the determination of such amount shall be based on the
18 schedule of unabsorbed premium deposit returns for each
19 such company then in effect.”

20 (3) CONFORMING AMENDMENT.—Section 832 (b)
21 (1) (C) is amended by striking out “section 831 (a),”
22 and inserting in lieu thereof “section 831 (a) (3) (A),”.

23 (4) ADJUSTMENT OF PREMIUM DEPOSIT.—Section
24 832 (c) (11) is amended to read as follows:

25 “(11) dividends and similar distributions paid or

1 declared to policyholders in their capacity as such, ex-
 2 cept in the case of a mutual fire insurance company de-
 3 scribed in section 831 (a) (3) (A). For purposes of
 4 the preceding sentence, the term 'dividends and similar
 5 distributions' includes amounts returned or credited to
 6 policyholders on cancellation or expiration of policies
 7 described in section 831 (a) (3) (B). For purposes of
 8 this paragraph, the term 'paid or declared' shall be con-
 9 strued according to the method of accounting regularly
 10 employed in keeping the books of the insurance com-
 11 pany; and''.

12 (5) ADDITIONAL ITEM OF INCOME.—Section
 13 832 (b) (1) is amended by striking out "and" at the end
 14 of subparagraph (B), by striking out the period at the
 15 end of subparagraph (C) and inserting in lieu thereof
 16 ", and", and by adding at the end thereof the following
 17 new subparagraph:

18 "(D) in the case of a mutual fire insurance
 19 company described in section 831 (a) (3) (B), an
 20 amount equal to 2 percent of the premiums earned
 21 on insurance contracts during the taxable year with
 22 respect to policies described in section 831 (a) (3)
 23 (B) after deduction of premium deposits returned
 24 or credited during the same taxable year."

25 (e) ELECTION OF CERTAIN MUTUAL COMPANIES To

1 BE TAXED ON TOTAL INCOME.—Section 831 is amended
2 by redesignating subsection (c) as subsection (d), and by
3 inserting after subsection (b) the following new subsection:

4 “(c) ELECTION FOR MULTIPLE LINE COMPANY TO BE
5 TAXED ON TOTAL INCOME.—

6 “(1) IN GENERAL.—Any mutual insurance com-
7 pany engaged in writing marine, fire, and casualty insur-
8 ance which for any 5-year period beginning after
9 December 31, 1941, and ending before January 1, 1962,
10 was subject to the tax imposed by section 831 (or the
11 tax imposed by corresponding provisions of prior law)
12 may elect, in such manner and at such time as the
13 Secretary or his delegate may by regulations prescribe,
14 to be subject to the tax imposed by section 831, whether
15 or not marine insurance is its predominant source of
16 premium income.

17 “(2) EFFECT OF ELECTION.—If an election is
18 made under paragraph (1), the electing company shall
19 (in lieu of being subject to the tax imposed by section
20 821) be subject to the tax imposed by this section for
21 taxable years beginning after December 31, 1961.
22 Such election shall not be revoked except with the con-
23 sent of the Secretary or his delegate.”

24 (f) TECHNICAL AMENDMENTS, ETC.—

25 (1) CREDIT FOR FOREIGN TAXES.—Section 841

1 (relating to credit for foreign taxes) is amended
 2 by striking out “and” at the end of paragraph (1), by
 3 renumbering paragraph (2) as paragraph (3), and by
 4 inserting after paragraph (1) the following new para-
 5 graph:

6 “(2) in the case of the tax imposed by section
 7 821 (a), the mutual insurance company taxable income
 8 (as defined in section 821 (b)); and in the case of the
 9 tax imposed by section 821 (c), the taxable investment
 10 income (as defined in section 822 (a)), and”.

11 (2) ADJUSTMENTS TO BASIS FOR DEPRECIATION
 12 SUSTAINED.—Section 1016 (a) (3) (relating to adjust-
 13 ments to basis for depreciation, etc., sustained) is
 14 amended by striking out “and” at the end of subpara-
 15 graph (B), by inserting “and” at the end of sub-
 16 paragraph (C), and by inserting after subparagraph
 17 (C) the following new subparagraph:

18 “(D) since February 28, 1913, during which
 19 such property was held by a person subject to tax
 20 under part II of subchapter L (or the corresponding
 21 provisions of prior income tax laws), to the extent
 22 that paragraph (2) does not apply,”.

23 (3) ALTERNATIVE TAX ON CAPITAL GAINS.—
 24 Section 1201 (a) (relating to alternative tax on corpo-

1 rations) is amended by striking out “821 (a) (1) or
2 (b),” and inserting in lieu thereof “821 (a) or (c),”.

3 (4) CLERICAL AMENDMENT.—The table of parts
4 for subchapter L is amended by striking out the portion
5 referring to part II and inserting in lieu thereof the
6 following:

“Part II. Mutual insurance companies (other than life and
certain marine insurance companies and other
than fire insurance companies which operate on
basis of perpetual policies or premium de-
posits).”

7 (g) EFFECTIVE DATE.—The amendments made by this
8 section (other than by subsection (e)) shall apply with re-
9 spect to taxable years beginning after December 31, 1962.

10 **SEC. 11. DOMESTIC CORPORATIONS RECEIVING DIVI-**
11 **DENDS FROM FOREIGN CORPORATIONS.**

12 (a) ENTIRE AMOUNT OF FOREIGN TAX TO BE TAKEN
13 INTO ACCOUNT.—

14 (1) DEFINITION OF ACCUMULATED PROFITS.—So
15 much of paragraph (1) of section 902 (c) (relating to
16 applicable rules for computing credit for corporate stock-
17 holder in foreign corporation) as precedes the semicolon
18 is amended to read as follows:

19 “(1) The term ‘accumulated profits’, when used in
20 this section in reference to a foreign corporation, means
21 the amount of its gains, profits, or income computed

1 without reduction by the amount of the income, war
2 profits, and excess profits taxes imposed on or with re-
3 spect to such profits or income by any foreign country
4 or any possession of the United States”.

5 (2) CONFORMING AMENDMENTS.—

6 (A) Section 902 (a) is amended by striking
7 out “which the amount of such dividends bears to
8 the amount of such accumulated profits” and insert-
9 ing in lieu thereof “which the amount of such
10 dividends (determined without regard to section
11 78) bears to the amount of such accumulated profits
12 in excess of such income, war profits, and excess
13 profits taxes (other than those deemed paid)”.

14 (B) Section 902 (b) is amended by striking
15 out “which the amount of such dividends bears to
16 the amount of such accumulated profits” and in-
17 serting in lieu thereof “which the amount of such
18 dividends bears to the amount of such accumulated
19 profits in excess of such income, war profits, and
20 excess profits taxes”.

21 (b) INCLUSION IN GROSS INCOME OF AMOUNT
22 EQUAL TO TAXES DEEMED PAID.—Part II of subchapter B
23 of chapter 1 (relating to items specifically included in gross
24 income) is amended by adding at the end thereof the fol-
25 lowing new section:

1 **“SEC. 78. DIVIDENDS RECEIVED FROM FOREIGN CORPO-**
2 **RATIONS BY DOMESTIC CORPORATIONS CHOOS-**
3 **ING FOREIGN TAX CREDIT.**

4 “If a domestic corporation chooses to have the benefits
5 of subpart A of part III of subchapter N (relating to foreign
6 tax credit) for any taxable year, an amount equal to the
7 taxes deemed to be paid by such corporation under section
8 902 (relating to credit for corporate stockholder in foreign
9 corporation) or under section 957 (a) (relating to taxes
10 paid by foreign corporation) for such taxable year shall be
11 treated for purposes of this title (other than section 245) as
12 a dividend received by such domestic corporation from the
13 foreign corporation.”

14 (c) DETERMINATION OF SOURCE OF DIVIDENDS RE-
15 CEIVED FROM CERTAIN FOREIGN CORPORATIONS.—Section
16 861 (a) (2) (B) (relating to dividends from foreign cor-
17 porations treated as income from sources within the United
18 States) is amended by striking out “to the extent exceeding
19 the amount of the deduction allowable under section 245 in
20 respect of such dividends” and inserting in lieu thereof “to
21 the extent exceeding the amount which is 100/85ths of the
22 amount of the deduction allowable under section 245 in
23 respect of such dividends”.

24 (d) REPEAL OF SECTION 902 (d).—Subsection (d)

1 (relating to special rules for certain wholly owned foreign
2 corporations) is hereby repealed.

3 (e) TECHNICAL AMENDMENTS.—

4 (1) The table of sections for part II of subchapter
5 B of chapter 1 is amended by adding at the end thereof
6 the following:

“Sec. 78. Dividends received from foreign corporations by
domestic corporations choosing foreign tax
credit.”

7 (2) Section 535 (b) (1) and the first sentence of
8 section 545 (b) (1) are each amended by striking out
9 “accrued during the taxable year,” and inserting in lieu
10 thereof “accrued during the taxable year or deemed to
11 be paid by a domestic corporation under section 902 for
12 the taxable year,”.

13 (3) Section 901 (d) is amended by adding the
14 following new paragraph:

“(4) For reduction of credit for failure of a United
States person to furnish certain information with respect
to a foreign corporation controlled by him, see section
6038.”

15 (4) Section 902 is amended by striking out subsec-
16 tion (e) and inserting in lieu thereof the following:

17 “(d) CROSS REFERENCES.—

“(1) For inclusion in gross income of an amount equal
to taxes deemed paid under this section, see section 78.

“(2) For reduction of credit with respect to dividends
paid out of accumulated profits for years for which cer-
tain information is not furnished, see section 6038.”

1 (f) EFFECTIVE DATE.—The amendments made by this
2 section shall apply—

3 (1) in respect of any distribution received by a
4 domestic corporation after December 31, 1964, and

5 (2) in respect of any distribution received by a
6 domestic corporation before January 1, 1965, in a tax-
7 able year of such corporation beginning after December
8 31, 1962, but only to the extent that such distribution
9 is made out of the accumulated profits of a foreign
10 corporation for a taxable year (of such foreign corpora-
11 tion) beginning after December 31, 1962.

12 For purposes of paragraph (2), a distribution made by a
13 foreign corporation out of its profits which are attributable
14 to a distribution received from a foreign subsidiary to which
15 section 902 (b) applies shall be treated as made out of the
16 accumulated profits of a foreign corporation for a taxable
17 year beginning before January 1, 1963, to the extent that
18 such distribution was paid out of the accumulated profits of
19 such foreign subsidiary for a taxable year beginning before
20 January 1, 1963.

1 SEC. 12. EARNED INCOME FROM SOURCES WITHOUT THE
2 UNITED STATES.

3 (a) LIMITATION ON AMOUNT AND TYPE OF INCOME
4 EXCLUDED.—Section 911 (relating to earned income from
5 sources without the United States) is amended to read as
6 follows:

7 “SEC. 911. EARNED INCOME FROM SOURCES WITHOUT
8 THE UNITED STATES.

9 “(a) GENERAL RULE.—The following items shall not
10 be included in gross income and shall be exempt from taxa-
11 tion under this subtitle:

12 “(1) BONA FIDE RESIDENT OF FOREIGN COUN-
13 TRY.—In the case of an individual citizen of the United
14 States who establishes to the satisfaction of the Secre-
15 tary or his delegate that he has been a bona fide resident
16 of a foreign country or countries for an uninterrupted
17 period which includes an entire taxable year, amounts
18 received from sources without the United States (except
19 amounts paid by the United States or any agency there-
20 of) which constitute earned income attributable to serv-
21 ices performed during such uninterrupted period. The
22 amount excluded under this paragraph for any taxable
23 year shall be computed by applying the special rules
24 contained in subsection (c).

25 “(2) PRESENCE IN FOREIGN COUNTRY FOR 17

MONTHS.—In the case of an individual citizen of the United States who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during such 18-month period. The amount excluded under this paragraph for any taxable year shall be computed by applying the special rules contained in subsection (c).

An individual shall not be allowed, as a deduction from his gross income, any deductions (other than those allowed by section 151, relating to personal exemptions) properly allocable to or chargeable against amounts excluded from gross income under this subsection.

“(b) DEFINITION OF EARNED INCOME.—For purposes of this section, the term ‘earned income’ means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of

1 a taxpayer engaged in a trade or business in which both
2 personal services and capital are material income-producing
3 factors, under regulations prescribed by the Secretary or his
4 delegate, a reasonable allowance as compensation for the
5 personal services rendered by the taxpayer, not in excess of
6 30 percent of his share of the net profits of such trade or
7 business, shall be considered as earned income.

8 “(c) SPECIAL RULES.—For purposes of computing the
9 amount excludable under subsection (a), the following rules
10 shall apply:

11 “(1) LIMITATIONS ON AMOUNT OF EXCLUSION.—
12 The amount excluded from the gross income of an
13 individual under subsection (a) for any taxable year
14 shall not exceed an amount which shall be computed on
15 a daily basis at an annual rate of—

16 “(A) except as provided in subparagraph (B),
17 \$20,000 in the case of an individual who qualifies
18 under subsection (a), or

19 “(B) \$35,000 in the case of an individual who
20 qualifies under subsection (a) (1), but only with
21 respect to that portion of such taxable year occurring
22 after such individual has been a bona fide resident
23 of a foreign country or countries for an uninterrupted
24 period of 3 consecutive years.

25 “(2) ATTRIBUTION TO YEAR IN WHICH SERVICES

1 ARE PERFORMED.—For purposes of applying paragraph
2 (1), amounts received shall be considered received in
3 the taxable year in which the services to which the
4 amounts are attributable are performed.

5 “(3) TREATMENT OF COMMUNITY INCOME.—In
6 applying paragraph (1) with respect to amounts re-
7 ceived for services performed by a husband or wife
8 which are community income under community prop-
9 erty laws applicable to such income, the aggregate
10 amount excludable under subsection (a) from the gross
11 income of such husband and wife shall equal the amount
12 which would be excludable if such amounts did not con-
13 stitute such community income.

14 “(4) REQUIREMENT AS TO TIME OF RECEIPT.—
15 No amount received after the close of the taxable year
16 following the taxable year in which the services to which
17 the amounts are attributable are performed may be ex-
18 cluded under subsection (a).

19 “(5) CERTAIN AMOUNTS NOT EXCLUDABLE.—No
20 amount—

21 “(A) received as a pension or annuity, or

22 “(B) included in gross income by reason of
23 section 402 (b) (relating to taxability of benefi-
24 ciary of non-exempt trust), section 403 (c) (relat-
25 ing to taxability of beneficiary under a non-quali-

1 fied annuity), or section 403 (d) (relating to
2 taxability of beneficiary under certain forfeitable
3 contracts purchased by exempt organizations),
4 may be excluded under subsection (a).

5 “(d) CROSS REFERENCES.—

 “**For administrative and penal provisions relating to
the exclusion provided for in this section, see sections
6001, 6011, 6012(c), and the other provisions of subtitle F.**”

6 (b) COMPUTATION OF EMPLOYEES' CONTRIBU-
7 TIONS.—Section 72 (f) (relating to special rules for comput-
8 ing employees' contributions) is amended by adding after
9 paragraph (2) the following new sentences:
10 “Paragraph (2) shall not apply to amounts which were con-
11 tributed by the employer after December 31, 1962, and
12 which would not have been includible in the gross income of
13 the employee by reason of the application of section 911 if
14 such amounts had been paid directly to the employee at the
15 time of contribution. The preceding sentence shall not apply
16 to amounts which were contributed by the employer, as de-
17 termined under regulations prescribed by the Secretary or his
18 delegate, to provide pension or annuity credits, to the extent
19 such credits are attributable to services performed before
20 January 1, 1963, and are provided pursuant to pension or
21 annuity plan provisions in existence on March 12, 1962,
22 and on that date applicable to such services.”

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years ending after December 31, 1962.

(2) AMENDMENTS TO SECTION 911.—The amendment made by subsection (a) shall apply only with respect to amounts received after December 31, 1962, and which are attributable either to—

(A) services performed after such date, or

(B) services performed on or before such date, but only if on March 12, 1962, there existed no right (whether forfeitable or nonforfeitable) to receive such amounts.

SEC. 13. CONTROLLED FOREIGN CORPORATIONS.

(a) IN GENERAL.—Part III of subchapter N of chapter 1 (relating to income from sources without the United States) is amended by adding at the end thereof the following new subpart:

“Subpart F—Controlled Foreign Corporations

“Sec. 951. Amounts included in gross income of United States persons.

“Sec. 952. Subpart F income defined.

“Sec. 953. Investment of earnings in nonqualified property.

“Sec. 954. Controlled foreign corporations.

“Sec. 955. Rules for determining stock ownership.

“Sec. 956. Exclusion from gross income of previously taxed earnings and profits.

“Sec. 957. Special rules for foreign tax credit.

“Sec. 958. Adjustments to basis of stock in controlled foreign corporations and of other property.

1 **“SEC. 951. AMOUNTS INCLUDED IN GROSS INCOME OF**
2 **UNITED STATES PERSONS.**

3 **“(a) AMOUNTS INCLUDED.—**

4 **“(1) IN GENERAL.—**If a foreign corporation is a
5 controlled corporation on any day of a taxable year be-
6 ginning after December 31, 1962, every United States
7 person (as defined in section 7701 (a) (30)) who owns
8 (within the meaning of section 955 (a)) stock in such
9 corporation on the last day, in such year, on which such
10 corporation is a controlled foreign corporation shall in-
11 clude in his gross income, for his taxable year in which
12 or with which such taxable year of the corporation
13 ends—

14 **“(A) his pro rata share (determined under**
15 **paragraph (2)) of the corporation’s subpart F**
16 **income for such year, and**

17 **“(B) his pro rata share (determined under**
18 **section 953 (a) (2)) of the corporation’s increase**
19 **in earnings invested in nonqualified property for**
20 **such year (but only to the extent not excluded**
21 **from gross income under section 956 (a) (2)).**

22 **“(2) PRO RATA SHARE OF SUBPART F INCOME.—**

23 The pro rata share referred to in paragraph (1) (A)
24 in the case of any United States person is the amount—

25 **“(A) which would have been distributed with**

1 respect to the stock which such person owns (with-
2 in the meaning of section 955 (a)) in such cor-
3 poration if on the last day, in its taxable year, on
4 which the corporation is a controlled foreign cor-
5 poration it had distributed pro rata to its share-
6 holders an amount (i) which bears the same ratio
7 to its subpart F income for the taxable year, as
8 (ii) the part of such year during which the corpora-
9 tion is a controlled foreign corporation bears to the
10 entire year, reduced by

11 “(B) the amount of any distribution received
12 by any other United States person during such
13 year as a dividend with respect to such stock.

14 “(3) LIMITATION ON AMOUNT OF PRO RATA
15 SHARE OF INVESTMENT IN NONQUALIFIED PROPERTY
16 INCLUDED IN GROSS INCOME.—For purposes of para-
17 graph (1) (B) , the pro rata share of any United States
18 person in the increase of the earnings of a controlled
19 foreign corporation invested in nonqualified property
20 shall not exceed an amount (A) which bears the same
21 ratio to his pro rata share of such increase (as deter-
22 mined under section 953 (a) (2)) for the taxable
23 year, as (B) the part of such year during which the
24 corporation is a controlled foreign corporation bears to
25 the entire year.

1 “(b) LESS THAN 10-PERCENT OWNERSHIP.—No per-
2 son shall be required to include any amount in gross income
3 under subsection (a) unless he can be considered, by apply-
4 ing the rules of ownership of section 955(b), as owning,
5 directly or indirectly, on any day during the taxable year
6 of the corporation on which it was a controlled foreign cor-
7 poration, 10 percent or more of the total combined voting
8 power of all classes of stock, or of the total value of shares
9 of all classes of stock, of such corporation.

10 “(c) COORDINATION WITH ELECTION OF A FOREIGN
11 INVESTMENT COMPANY TO DISTRIBUTE INCOME.—A
12 United States person who, for his taxable year, is a qualified
13 shareholder (within the meaning of section 1247(c)) of a
14 foreign investment company with respect to which an elec-
15 tion under section 1247 is in effect shall not be required to
16 include in gross income, for such taxable year, subpart F
17 income of such company.

18 “SEC. 952. SUBPART F INCOME DEFINED.

19 “(a) IN GENERAL.—

20 “(1) ITEMS TAKEN INTO ACCOUNT.—For purposes
21 of this subpart, the term ‘subpart F income’ means, in
22 the case of any controlled foreign corporation, the sum
23 of—

24 “(A) income derived from insurance of United
25 States risks (as determined under subsection (b)),

“(B) income from United States patents, copyrights, and exclusive formulas and processes (as determined under subsection (c)), and

“(C) the net foreign base company income (as determined under subsection (d)), except that this subparagraph shall apply only in the case of a controlled foreign corporation in which 5 or fewer United States persons own, by applying the rules of ownership of section 955 (b), more than 50 percent of the total combined voting power of all classes of stock entitled to vote.

“(2) EXCLUSION OF UNITED STATES INCOME.—

Subpart F income does not include any item includible in gross income under this chapter (other than this subpart) as income derived from sources within the United States of a foreign corporation engaged in trade or business in the United States.

“(3) NOT TO EXCEED EARNINGS AND PROFITS.—

The subpart F income of any controlled foreign corporation for any taxable year shall not exceed the earnings and profits of such corporation for such year.

“(b) INCOME FROM INSURANCE OF UNITED STATES RISKS.—

“(1) GENERAL RULE.—If a controlled foreign corporation receives premiums or other consideration in

1 respect of any reinsurance or the issuing of any insurance
2 or annuity contract—

3 “(A) in connection with property in, or resi-
4 dents of, the United States, or

5 “(B) in connection with property not in, or
6 nonresidents of, the United States as the result of
7 any arrangement whereby another corporation re-
8 ceives a substantially equal amount of premiums or
9 other consideration in respect of any reinsurance or
10 the issuing of any insurance or annuity contract in
11 connection with property in, or residents of, the
12 United States,

13 then for purposes of subsection (a) (1) (A), the term
14 ‘income derived from the insurance of United States
15 risks’ means that income which (subject to the modifi-
16 cations provided by subparagraphs (A), (B), and (C)
17 of paragraph (2)) would be taxed under subchapter L
18 of this chapter if such corporation were a domestic
19 corporation.

20 “(2) SPECIAL RULES.—For purposes of paragraph
21 (1) —

22 “(A) In the application of part I of subchapter
23 L, life insurance company taxable income is the
24 gain from operations as defined in section 809 (b) .

1 “(B) A corporation which would, if it were a
2 domestic corporation, be taxable under part II of
3 subchapter L shall apply paragraph (1) as if it
4 were taxable under part III of subchapter L.

5 “(C) The following provisions of subchapter L
6 shall not apply:

7 “(i) Section 809 (d) (4) (operations loss
8 deduction) .

9 “(ii) Section 809 (d) (5) (certain non-
10 participating contracts) .

11 “(iii) Section 809 (d) (6) (group life,
12 accident, and health insurance) .

13 “(iv) Section 809 (d) (10) (small busi-
14 ness deduction) .

15 “(v) Section 817 (b) (gain on property
16 held on December 31, 1958, and certain sub-
17 stituted property acquired after 1958) .

18 “(vi) Section 832 (b) (5) (certain capital
19 losses) .

20 “(D) ‘Gross amount’ to the extent provided in
21 section 809 (c) (1) and (2), less ‘increase in
22 certain reserves’ as defined in section 809 (d) (2),
23 and ‘premiums earned’ as defined in section 832 (b)
24 (4) shall be taken into account only to the extent

1 they are in respect of any reinsurance or the issuing
 2 of any reinsurance or the issuing of any insurance
 3 or annuity contract described in paragraph (1).

4 “(E) All items of income (other than those
 5 taken into account under subparagraph (D)) and
 6 all items of expenses, losses, and deductions shall
 7 be properly allocated or apportioned under regula-
 8 tions prescribed by the Secretary or his delegate.

9 “(c) INCOME FROM UNITED STATES PATENTS, COPY-
 10 RIGHTS, AND EXCLUSIVE FORMULAS AND PROCESSES.—

11 “(1) GENERAL RULE.—For purposes of subsection
 12 (a) (1) (B), the term ‘income from United States
 13 patents, copyrights, and exclusive formulas and proc-
 14 esses’, means the amount of gross rentals, royalties, or
 15 other income derived from the license, sublicense, sale,
 16 exchange, use, or other means of exploitation of patents,
 17 copyrights, and exclusive formulas and processes—

18 “(A) substantially developed, created, or pro-
 19 duced in the United States, or

20 “(B) acquired from any United States person
 21 which, directly or indirectly, owns or controls, or
 22 is owned or controlled by, or is under common
 23 ownership or control with, the controlled foreign
 24 corporation,

1 less the cost and expense allowance defined in para-
2 graph (2).

3 “(2) COST AND EXPENSE ALLOWANCE.—An al-
4 lowance shall be made, in accordance with regulations
5 prescribed by the Secretary or his delegate, for ordinary
6 and necessary expenses incurred by the controlled foreign
7 corporation in the receipt or production of the income
8 described in paragraph (1), including taxes and any
9 amortization or depreciation of the cost to such corpo-
10 ration of such property or rights described in paragraph
11 (1), but not including any production, manufacturing,
12 or similar expenses incurred in the use or other means
13 of exploitation of such property or rights.

14 “(3) DETERMINATION OF INCOME FROM USE.—
15 The income from use or other means of exploitation by
16 the controlled foreign corporation of the property or
17 right described in paragraph (1) shall be the amount
18 which would be obtained as a gross rent, royalty, or
19 other payment in an arm's length transaction with an
20 unrelated person for similar use or exploitation, of the
21 property or right.

22 “(d) NET FOREIGN BASE COMPANY INCOME.—For
23 purposes of subsection (a) (1) (C), the term ‘net foreign
24 base company income’ means—

1 “(1) the foreign base company income for the tax-
2 able year, determined under subsection (e), reduced
3 by

4 “(2) the increase in investment in qualified prop-
5 erty in less developed countries for the taxable year,
6 determined under subsection (f).

7 “(e) FOREIGN BASE COMPANY INCOME.—

8 “(1) IN GENERAL.—For purposes of subsection
9 (d) (1), the term ‘foreign base company income’ means
10 the foreign personal holding company income (as de-
11 fined in section 553) for the taxable year, modified and
12 adjusted as provided in this subsection.

13 “(2) CERTAIN SALES INCOME INCLUDED.—The
14 term ‘foreign base company income’ includes foreign
15 base company sales income if, for the taxable year, such
16 income is equal to at least 20 percent of the gross income
17 of the foreign corporation (not including for this purpose
18 other foreign base company income under this subsec-
19 tion). For purposes of this paragraph, the term ‘foreign
20 base company sales income’ means income (whether in
21 the form of profits, commissions, fees, or otherwise)
22 derived in connection with the purchase of personal
23 property from a related person and its sale to any per-
24 son, or the purchase of personal property from any
25 person and its sale to a related person, where—

1 “(A) the property which is purchased is manu-
2 factured, produced, grown, or extracted outside
3 the country under the laws of which the controlled
4 foreign corporation is created or organized, and

5 “(B) the property is sold for use, consumption,
6 or disposition outside such foreign country.

7 For purposes of the preceding sentence, a person is a
8 related person with respect to the controlled foreign
9 corporation if he, directly or indirectly, owns or con-
10 trols, or is owned or controlled by, or is under common
11 ownership or control with, the controlled foreign
12 corporation.

13 “(3) RENTS INCLUDED WITHOUT REGARD TO 50-
14 PERCENT LIMITATION.—All rents shall be included in
15 foreign base company income without regard to whether
16 or not such rents constitute more than 50 percent of
17 gross income.

18 “(4) INSURANCE AND PATENT INCOME EX-
19 CLUDED.—The term ‘foreign base company income’ does
20 not include any income derived from insurance of United
21 States risks (as determined under subsection (b)) or
22 income from United States patents, copyrights, and ex-
23 clusive formulas and processes (as determined under
24 subsection (c)).

1 “(5) INCOME OF CERTAIN BANKS AND BANK-
2 CONTROLLED CORPORATIONS EXCLUDED.—The term
3 ‘foreign base company income’ does not include—

4 “(A) the income of any corporation de-
5 scribed in section 552 (b) (relating to excep-
6 tion for banks and exempt corporations), or

7 “(B) the income of any foreign corporation
8 if 50 percent or more of the fair market value of
9 its outstanding stock is owned directly or indirectly
10 by a domestic corporation which is either organ-
11 ized under section 25 (a) of the Federal Reserve
12 Act (12 U.S.C., secs. 611–631), or has an agree-
13 ment or understanding with the Board of Gover-
14 nors of the Federal Reserve System under section
15 25 of the Federal Reserve Act (12 U.S.C., secs.
16 601–604), if all of the stock (except qualifying
17 shares) of the domestic corporation is owned by a
18 national or State bank which is a member of the
19 Federal Reserve System.

20 “(6) SPECIAL RULE WHERE FOREIGN BASE COM-
21 PANY INCOME IS LESS THAN 20 PERCENT OR MORE
22 THAN 80 PERCENT OF GROSS INCOME.—For purposes
23 of this subsection—

24 “(A) If the foreign base company income
25 (determined without regard to paragraph (7))

1 is less than 20 percent of gross income, no part of
 2 the gross income of the taxable year shall be
 3 treated as foreign base company income.

4 “(B) If the foreign base company income
 5 (determined without regard to paragraph (7))
 6 exceeds 80 percent of gross income, the entire
 7 gross income of the taxable year shall be taken
 8 into account in determining foreign base company
 9 income.

10 “(7) DEDUCTIONS TO BE TAKEN INTO AC-
 11 COUNT.—The foreign base company income for the tax-
 12 able year shall be reduced so as to take into account
 13 deductions (including taxes) properly allocable to such
 14 income.

15 “(f) INVESTMENT IN QUALIFIED PROPERTY IN LESS
 16 DEVELOPED COUNTRIES.—

17 “(1) GENERAL RULE.—For purposes of subsection
 18 (d) (2), the increase in investment in qualified property
 19 in less developed countries for any taxable year is the
 20 amount by which—

21 “(A) the aggregate amount of property de-
 22 scribed in sections 953 (b) (2) (C) and (D) and
 23 property (including money) which is located out-
 24 side the United States and is ordinary and necessary
 25 for the active conduct of a qualified trade or business

1 described in section 953 (b) (3) (A) (ii) held at
2 the close of the taxable year, exceeds

3 “(B) the aggregate amount of property de-
4 scribed in subparagraph (A) held at the close of
5 the preceding taxable year.

6 “(2) INVESTMENTS AFTER CLOSE OF YEAR.—
7 Under regulations prescribed by the Secretary or his
8 delegate, a controlled foreign corporation may elect to
9 make the determinations under subparagraphs (A)
10 and (B) of paragraph (1) as of the close of the 75th
11 day after the close of each taxable year.

12 “(3) AMOUNT ATTRIBUTABLE TO PROPERTY.—
13 The amount taken into account under paragraph (1)
14 with respect to any property shall be its adjusted basis,
15 reduced by any liability to which the property is subject.

16 **“SEC. 953. INVESTMENT OF EARNINGS IN NONQUALIFIED**
17 **PROPERTY.**

18 “(a) GENERAL RULES.—For purposes of this subpart—

19 “(1) AMOUNT OF INVESTMENT.—The amount of
20 earnings of a controlled foreign corporation invested in
21 nonqualified property at the close of any taxable year
22 is the aggregate amount of such property held at the
23 close of the taxable year, to the extent such amount
24 does not exceed the sum of (A) the earnings and profits
25 for the taxable year, and (B) the earnings and profits

accumulated for prior taxable years beginning after December 31, 1962.

“(2) PRO RATA SHARE OF INCREASE FOR YEAR.—

In the case of any United States person, the pro rata share of the increase for any taxable year in the earnings of a controlled foreign corporation invested in a nonqualified property is the amount determined by subtracting—

“(A) his pro rata share of the amount determined under paragraph (1) for the close of the preceding taxable year, reduced by amounts paid during the taxable year to which section 956 (c) (1) applies, from

“(B) his pro rata share of the amount determined under paragraph (1) for the close of the taxable year.

“(3) AMOUNT ATTRIBUTABLE TO PROPERTY.—

The amount taken into account under paragraph (1) or (2) with respect to any property shall be its adjusted basis, reduced by any liability to which the property is subject.

“(b) NONQUALIFIED PROPERTY DEFINED.—For purposes of this subpart—

“(1) GENERAL RULE.—The term ‘nonqualified property’ means any money or other property (tangible

1 or intangible) acquired after December 31, 1962,
2 which is not qualified property.

3 “(2) QUALIFIED PROPERTY.—The term ‘qualified
4 property’ means—

5 “(A) Any money or other property which is
6 located outside the United States and is ordinary
7 and necessary for the active conduct of a qualified
8 trade or business (as determined under paragraph
9 (3)) carried on by the controlled foreign corpora-
10 tion.

11 “(B) Property which would qualify under sub-
12 paragraph (A) except for the fact that it is located
13 in the United States, but only if such property is—

14 “(i) obligations of the United States,
15 money, or deposits with persons carrying on
16 the banking business;

17 “(ii) property purchased in the United
18 States for export to, or for use in, foreign
19 countries; or

20 “(iii) any loan arising in connection with
21 the sale of property if the amount of such loan
22 outstanding at no time during the taxable year
23 exceeds the amount which would be ordinary
24 and necessary to carry on the trade or business
25 of both the lending corporation and the borrow-

1 ing United States person had the sale been
2 made between unrelated persons.

3 “(C) Stock owned by the controlled foreign
4 corporation in another controlled foreign corpora-
5 tion in which it owns at least 10 percent of the vot-
6 ing stock and 10 percent of the value of all classes of
7 stock and in which it together with four or fewer
8 United States persons, owns, directly or indirectly,
9 more than 50 percent of the voting stock (unless
10 under the laws of a less developed country such per-
11 centage of ownership is not permitted, in which
12 case such lesser percentage as is permitted) ; but this
13 subparagraph shall apply only if—

14 “(i) substantially all of the property of
15 such other controlled foreign corporation is or-
16 dinary and necessary for the active conduct of
17 a trade or business engaged in by it almost
18 wholly within a less developed country or
19 countries, and

20 “(ii) such other controlled foreign cor-
21 poration is created or organized under the laws
22 of one of such countries in which it is so en-
23 gaged.

24 “(D) Any investment which is required
25 because of restrictions imposed by a less developed

1 country, and any investment which, when made,
2 was so required and which would result in substan-
3 tial losses if withdrawn.

4 “(3) QUALIFIED TRADE OR BUSINESS.—

5 “(A) A trade or business is a qualified trade or
6 business if such trade or business (or substantially
7 the same trade or business) —

8 “(i) is carried on by the controlled foreign
9 corporation outside the United States and has
10 been so carried on by such corporation, while
11 controlled by substantially the same United
12 States persons since December 31, 1962, or
13 during the 5-year period ending with the close
14 of the preceding taxable year, or

15 “(ii) is carried on by the controlled foreign
16 corporation almost wholly within a less devel-
17 oped country or countries.

18 “(B) A trade or business which is a qualified
19 trade or business for a corporation in which the
20 controlled foreign corporation owns at least 80 per-
21 cent of the total combined voting power of all classes
22 of stock entitled to vote and at least 80 percent of

1 the total value of all classes of stock shall be treated
2 as a qualified trade or business for the controlled
3 foreign corporation if such percentage of stock was
4 owned continuously since December 31, 1962, or
5 during the 5-year period ending with the close of
6 the preceding taxable year.

7 “(4) SITUS OF CERTAIN PROPERTY.—Property
8 which is an obligation of, or pledges and guarantees
9 made with respect to obligations of, United States persons
10 shall be considered as property located in the United
11 States.

12 “(5) LESS DEVELOPED COUNTRY DEFINED.—The
13 term ‘less developed country’ means (in respect of any
14 foreign corporation) any foreign country (other than
15 an area within the Sino-Soviet bloc) or any possession
16 of the United States, with respect to which on the first
17 day of the taxable year, there is in effect an Executive
18 order by the President of the United States designating
19 such country or possession as an economically less de-
20 veloped country for purposes of this subpart. For pur-
21 poses of the preceding sentence, an oversea territory,
22 department, province, or possession may be treated as

1 a separate country. No designation shall be made under
2 this paragraph with respect to—

3	Australia	Liechtenstein
4	Austria	Luxembourg
5	Belgium	Monaco
6	Canada	Netherlands
7	Denmark	New Zealand
8	France	Norway
9	Germany (Federal	Union of South Africa
10	Republic)	San Marino
11	Hong Kong	Sweden
12	Italy	Switzerland
13	Japan	United Kingdom

14 **“SEC. 954. CONTROLLED FOREIGN CORPORATIONS.**

15 “(a) GENERAL RULE.—For purposes of this subpart,
16 the term ‘controlled foreign corporation’ means any foreign
17 corporation of which more than 50 percent of the total com-
18 bined voting power of all classes of stock entitled to vote is
19 owned, directly or indirectly (within the meaning of section
20 955 (b)), by United States persons on any day during the
21 taxable year of such foreign corporation.

22 “(b) SPECIAL RULE FOR INSURANCE.—For purposes
23 only of taking into account income described in section
24 952 (a) (1) (A) (relating to income derived from insurance
25 of United States risks), the term ‘controlled foreign corpora-

tion' includes not only a foreign corporation as defined by subsection (a) but also one of which more than 25 percent of the total combined voting power of all classes of stock is owned, directly or indirectly (within the meaning of section 955 (b)), by United States persons on any day during the taxable year of such corporation, if the gross amount of premiums or other consideration in respect of reinsurance or the issuing of insurance or annuity contracts in connection with property in, or residents of, the United States, exceeds 75 percent of the gross amount of all premiums or other consideration in respect of all risks.

“(c) SPECIAL RULE FOR CERTAIN LESS DEVELOPED COUNTRIES.—In the case of any foreign corporation to which section 953 (b) (2) (C) applies, the maximum percentage of ownership permitted under the laws of a less developed country shall be considered, in lieu of the more than 50 percent requirement in subsection (a), the percentage required under subsection (a) in order for the corporation to be classified as a controlled foreign corporation.

“SEC. 955. RULES FOR DETERMINING STOCK OWNERSHIP.

“(a) FOR PURPOSES OF SECTION 951 (a).—

“(1) GENERAL RULE.—For purposes of section 951 (a), stock owned means—

“(A) stock owned directly, and

1 “(B) stock owned with the application of para-
2 graph (2).

3 “(2) STOCK OWNERSHIP THROUGH FOREIGN EN-
4 TITIES.—For purposes of subparagraph (B) of para-
5 graph (1), stock owned, directly or indirectly, by or
6 for a foreign corporation, foreign partnership, or foreign
7 trust or foreign estate (within the meaning of section
8 7701 (a) (31)) shall be considered as being owned pro-
9 portionately by its shareholders, partners, or benefici-
10 aries. Stock considered to be owned by a person by reason
11 of the application of the preceding sentence shall, for
12 purposes of applying such sentence, be treated as actually
13 owned by such person.

14 “(3) SPECIAL RULE FOR MUTUAL INSURANCE
15 COMPANIES.—For purposes of applying paragraph (1)
16 in the case of a foreign mutual insurance company, the
17 term ‘stock’ shall include any certificate entitling the
18 holder to voting power in the corporation.

19 “(b) OTHER PROVISIONS.—For purposes of sections 951
20 (b), 952 (a) (1) (C), and 954, section 318 (a) (relating to
21 constructive ownership of stock) shall apply to the extent
22 that the effect is to subject a United States person to the
23 requirement of section 951 (a), to treat 5 or fewer United
24 States persons as owning more than 50 percent of all classes
25 of stock entitled to vote of a controlled foreign corporation,

1 or to make a foreign corporation a controlled foreign cor-
2 poration under section 954, except—

3 “(1) In applying paragraph (1) (A) of section
4 318 (a), stock owned by a nonresident alien individual
5 (other than a foreign trust or foreign estate) shall not
6 be considered as owned by a citizen or by a resident
7 alien individual.

8 “(2) In applying the first sentence of subpara-
9 graphs (A) and (B), and in applying clause (i) of
10 subparagraph (C), of section 318 (a) (2) —

11 “(A) if a partnership, estate, trust, or corpora-
12 tion owns, directly or indirectly, more than 50 per-
13 cent of the total combined voting power of all classes
14 of stock entitled to vote of a corporation, it shall be
15 considered as owning all the stock entitled to vote,
16 and

17 “(B) if a partnership, estate, trust, or corpora-
18 tion owns, directly or indirectly, more than 50 per-
19 cent of the total value of shares of all classes of stock
20 of a corporation, it shall be considered as owning
21 the total value of all of the outstanding stock of such
22 corporation. The application of this subparagraph
23 shall not have the effect of increasing voting power
24 of a partner, beneficiary, or shareholder, for pur-
25 poses of subparagraph (A).

1 “(3) Stock owned by a partnership, estate, trust,
 2 or corporation, by reason of the application of the second
 3 sentence of subparagraphs (A) and (B), and the appli-
 4 cation of clause (ii) of subparagraph (C), of section
 5 318 (a) (2), shall not be considered as owned by such
 6 partnership, estate, trust, or corporation, for the purposes
 7 of applying the first sentence of subparagraphs (A) and
 8 (B), and in applying clause (i) of subparagraph (C),
 9 of section 318 (a) (2).

10 “(4) In applying clause (i) of subparagraph (C)
 11 of section 318 (a) (2), the 50-percent limitation con-
 12 tained in subparagraph (C) shall not apply.

13 **“SEC. 956. EXCLUSION FROM GROSS INCOME OF PREVI-**
 14 **OUSLY TAXED EARNINGS AND PROFITS.**

15 “(a) **EXCLUSION FROM GROSS INCOME OF UNITED**
 16 **STATES PERSONS.**—For purposes of this chapter, the earn-
 17 ings and profits for a taxable year of a foreign corporation
 18 attributable to amounts which are, or have been, included in
 19 the gross income of a United States person under section
 20 951 (a) shall not, when—

21 “(1) such amounts are distributed to, or

22 “(2) such amounts would, but for this subsection,
 23 be included under section 951 (a) (1) (B) in the gross
 24 income of,

25 such person (or any other United States person who acquires

1 from any person any portion of the interest of such United
2 States person in such foreign corporation, but only to the ex-
3 tent of such portion, and subject to such proof of the identity
4 of such interest as the Secretary or his delegate may by regu-
5 lations prescribe) directly, or indirectly through a chain of
6 ownership described under section 955 (a) , be again included
7 in the gross income of such United States person (or of such
8 other United States person) .

9 “(b) EXCLUSION FROM GROSS INCOME OF CERTAIN
10 FOREIGN SUBSIDIARIES.—For purposes of section 951 (a) ,
11 the earnings and profits for a taxable year of a controlled
12 foreign corporation attributable to amounts which are, or
13 have been, included in the gross income of a United States
14 person under section 951 (a) , shall not, when distributed
15 through a chain of ownership described under section 955
16 (a) , be also included in the gross income of another con-
17 trolled foreign corporation in such chain for purposes of the
18 application of section 951 (a) to such other controlled foreign
19 corporation with respect to such United States person (or to
20 any other United States person who acquires from any per-
21 son any portion of the interest of such United States person
22 in the controlled foreign corporation, but only to the extent of
23 such portion, and subject to such proof of identity of such
24 interest as the Secretary or his delegate may prescribe by
25 regulations) .

1 “(c) **ALLOCATION OF DISTRIBUTIONS.**—For purposes
2 of subsections (a) and (b), section 316(a) shall be ap-
3 plied by applying paragraph (2) thereof, and then para-
4 graph (1) thereof—

5 “(1) first to earnings and profits attributable to
6 amounts included in gross income under section 951
7 (a) (1) (B) (or which would have been included except
8 for section 956(a) (2)),

9 “(2) then to earnings and profits attributable to
10 amounts included in gross income under section 951 (a)
11 (1) (A) (but reduced by amounts not included under
12 section 951 (a) (1) (B) because of the exclusion in sec-
13 tion 956(a) (2)), and

14 “(3) then to other earnings and profits.

15 “(d) **DISTRIBUTIONS EXCLUDED FROM GROSS IN-**
16 **COME NOT TO BE TREATED AS DIVIDENDS.**—Except as pro-
17 vided in section 957(a) (3), any distribution excluded from
18 gross income under subsection (a) shall be treated, for pur-
19 poses of this chapter, as a distribution which is not a
20 dividend.

21 **“SEC. 957. SPECIAL RULES FOR FOREIGN TAX CREDIT.**

22 “(a) **TAXES PAID BY A FOREIGN CORPORATION.**—

23 “(1) **GENERAL RULE.**—For purposes of subpart A
24 of this part, if there is included, under section 951(a),

1 in the gross income of a domestic corporation any
2 amount attributable to earnings and profits—

3 “(A) of a foreign corporation at least 10 per-
4 cent of the voting stock of which is directly owned
5 by such domestic corporation, or

6 “(B) of a foreign corporation at least 50 per-
7 cent of the voting stock of which is directly owned
8 by a foreign corporation at least 10 percent of the
9 voting stock of which is in turn directly owned by
10 such domestic corporation,

11 then, under regulations prescribed by the Secretary or
12 his delegate, such domestic corporation shall be deemed
13 to have paid the same proportion of the total income,
14 war profits, and excess profits taxes paid (or deemed
15 paid, if, paragraph (4) applies) to a foreign country
16 or possession of the United States for the taxable year
17 which the amount of earnings and profits of such foreign
18 corporation so included in gross income of the domestic
19 corporation bears to the entire amount of the total earn-
20 ings and profits of such foreign corporation for such
21 taxable year.

22 “(2) TAXES PREVIOUSLY DEEMED PAID BY DO-
23 MESTIC CORPORATION.—If a domestic corporation re-

1 ceives a distribution from a foreign corporation, any
2 portion of which is excluded from gross income under
3 section 956, the income, war profits, and excess profits
4 taxes paid or deemed paid by such foreign corporation
5 to any foreign country or to any possession of the United
6 States in connection with the earnings and profits of
7 such foreign corporation from which such distribution
8 is made shall not be taken into account for purposes
9 of section 902, to the extent such taxes were deemed
10 paid by such domestic corporation under paragraph (1)
11 for any prior taxable year.

12 “(3) TAXES PAID BY FOREIGN CORPORATION AND
13 NOT PREVIOUSLY DEEMED PAID BY DOMESTIC CORPORA-
14 TION.—Any portion of a distribution from a foreign cor-
15 poration received by a domestic corporation which is
16 excluded from gross income under section 956 (a) shall
17 be treated by the domestic corporation as a dividend,
18 solely for purposes of taking into account under section 902
19 any income, war profits, or excess profits taxes paid to
20 any foreign country or to any possession of the United
21 States, on or with respect to the accumulated profits of
22 such foreign corporation from which such distribution is
23 made, which were not deemed paid by the domestic
24 corporation under paragraph (1) for any prior taxable
25 year.

1 “(4) TAXES PAID BY A FOREIGN SUBSIDIARY.—If
 2 subparagraph (A) of paragraph (1) applies with re-
 3 spect to an amount included in gross income under sec-
 4 tion 951 (a) for a taxable year, then such amount shall
 5 be considered a dividend for purpose of the application
 6 of section 902 (b).

7 “(5) INCLUSION IN GROSS INCOME.—

**“For inclusion in gross income of amount equal to
 taxes deemed paid under paragraph (1), see section 78.**

8 “(b) SPECIAL RULES FOR FOREIGN TAX CREDIT IN
 9 YEAR OF RECEIPT OF PREVIOUSLY TAXED EARNINGS AND
 10 PROFITS.—

11 “(1) INCREASE IN SECTION 904 LIMITATION.—In
 12 the case of any taxpayer who—

13 “(A) either (i) chose to have the benefits of
 14 subpart A of this part for a taxable year in which
 15 he was required under section 951 (a) to include in
 16 his gross income an amount in respect of a con-
 17 trolled foreign corporation, or (ii) did not pay or
 18 accrue for such taxable year any income, war profits,
 19 or excess profits taxes to any foreign country or to
 20 any possession of the United States, and

21 “(B) chooses to have the benefits of subpart
 22 A of this part for the taxable year in which he re-
 23 ceives a distribution or amount which is excluded

1 from gross income under section 956 (a) and which
2 is attributable to earnings and profits of the con-
3 trolled foreign corporation which was included in
4 his gross income for the taxable year referred to in
5 subparagraph (A), and

6 “(C) for the taxable year in which such dis-
7 tribution or amount is received, pays, or is deemed
8 to have paid, or accrues income, war profits, or ex-
9 cess profits taxes to a foreign country or to any
10 possession of the United States with respect to such
11 distribution or amount,

12 the applicable limitation under section 904 for the tax-
13 able year in which such distribution or amount is re-
14 ceived shall be increased as provided in paragraph (2),
15 but such increase shall not exceed the amount of such
16 taxes paid, or deemed paid, or accrued with respect
17 to such distribution or amount.

18 “(2) AMOUNT OF INCREASE.—The amount of in-
19 crease of the applicable limitation under section 904 (a)
20 for the taxable year in which the distribution or amount
21 referred to in paragraph (1) (B) is received shall be
22 an amount equal to—

23 “(A) the amount by which the applicable lim-
24 itation under section 904 (a) for the taxable year
25 referred to in paragraph (1) (A) was increased by

1 reason of the inclusion in gross income under section
2 951 (a) of the amount in respect of the controlled
3 foreign corporation, reduced by

4 “(B) the amount of any income, war profits,
5 and excess profits taxes paid, or deemed paid, or
6 accrued to any foreign country or possession of the
7 United States which were allowable as a credit
8 under section 901 for the taxable year referred to in
9 paragraph (1) (A) and which would not have been
10 allowable but for the inclusion in gross income of the
11 amount described in subparagraph (A).

12 “(3) CASES IN WHICH TAXES NOT TO BE AL-
13 LOWED AS DEDUCTION.—In the case of any taxpayer
14 who—

15 “(A) chose to have the benefits of subpart A
16 of this part for a taxable year in which he was re-
17 quired under section 951 (a) to include in his gross
18 income an amount in respect of a controlled foreign
19 corporation, and

20 “(B) does not choose to have the benefits of
21 subpart A of this part for the taxable year in which
22 he receives a distribution or amount which is ex-
23 cluded from gross income under section 956 (a) and
24 which is attributable to earnings and profits of the
25 controlled foreign corporation which was included

1 in his gross income for the taxable year referred to
2 in subparagraph (A),
3 no deduction shall be allowed under section 164 for the
4 taxable year in which such distribution or amount is
5 received for any income, war profits, or excess profits
6 taxes paid or accrued to any foreign country or to any
7 possession of the United States on or with respect to
8 such distribution or amount.

9 “(4) INSUFFICIENT TAXABLE INCOME.—If an in-
10 crease in the limitation under this subsection exceeds the
11 tax imposed by this chapter for such year, the amount
12 of such excess shall be deemed an overpayment of tax
13 for such year.

14 **“SEC. 958. ADJUSTMENTS TO BASIS OF STOCK IN CON-**
15 **TROLLED FOREIGN CORPORATION AND OF**
16 **OTHER PROPERTY.**

17 “(a) INCREASE IN BASIS.—Under regulations pre-
18 scribed by the Secretary or his delegate, the basis of a United
19 States person’s stock in a controlled foreign corporation, and
20 the basis of property of a United States person by reason of
21 which he is considered under section 955 (a) (2) as owning
22 stock of a controlled foreign corporation, shall be increased
23 by the amount required to be included in his gross income
24 under section 951 (a) with respect to such stock or with
25 respect to such property, as the case may be, but only to the

1 extent to which such amount was included in the gross
2 income of such person.

3 “(b) REDUCTION IN BASIS.—

4 “(1) IN GENERAL.—Under regulations prescribed
5 by the Secretary or his delegate, the adjusted basis of
6 stock or other property with respect to which a United
7 States person receives an amount which is excluded from
8 gross income under section 956 (a) shall be reduced by
9 the amount so excluded.

10 “(2) AMOUNT IN EXCESS OF BASIS.—To the ex-
11 tent that an amount excluded from gross income under
12 section 956 (a) exceeds the adjusted basis of the stock
13 or other property with respect to which it is received,
14 the amount shall be treated as gain from the sale or
15 exchange of property.”

16 (b) TECHNICAL AND CLERICAL AMENDMENTS.—

17 (1) Section 551 (b) (relating to foreign personal
18 holding company income included in gross income of
19 United States shareholders) is amended by adding at
20 the end thereof the following new sentence: “The amount
21 included in the gross income of any United States share-
22 holder for any taxable year under the preceding sen-
23 tence shall be reduced by such shareholder’s proportion-
24 ate share of the undistributed personal holding company
25 income which is included in his gross income under

1 section 951 (a) (1) (A) (relating to amounts included
2 in gross income of United States persons) for such tax-
3 able year as his pro rata share of the subpart F income
4 of the company.”

5 (2) Section 901 (relating to foreign tax credit) is
6 amended by striking out “section 902” and inserting
7 in lieu thereof “sections 902 and 957”.

8 (3) Section 902 (e) is amended to read as follows:

9 “(e) CROSS REFERENCES.—

 “(1) For application of subsections (a) and (b) with
 respect to taxes deemed paid in a prior taxable year by
 a United States person with respect to a controlled
 foreign corporation, see section 957.

 “(2) For reduction of credit with respect to dividends
 paid out of accumulated profits for years for which cer-
 tain information is not furnished, see section 6038.”

10 (4) Section 904 (f) is amended to read as follows:

11 “(f) CROSS REFERENCES.—

 “(1) For increase of applicable limitation under sub-
 section (a) for taxes paid with respect to amounts re-
 ceived which were included in the gross income of the
 taxpayer for a prior taxable year as a United States
 person with respect to a controlled foreign corporation,
 see section 957(b).

 “(2) For special rule relating to the application of the
 credit provided by section 901 in the case of affiliated
 groups which include Western Hemisphere trade corpo-
 rations for years in which the limitation provided by sub-
 section (a)(2) applies, see section 1503(d).”

12 (5) The table of subparts for part III of subchapter
13 N of chapter 1 is amended by adding at the end thereof
14 the following:

 “Subpart F. Controlled foreign corporations.”

(6) Section 1016(a) (relating to adjustments to basis) is amended—

(A) by striking out the period at the end of paragraph (18) and inserting in lieu thereof a semicolon; and

(B) by adding after paragraph (18) the following new paragraph:

“(19) to the extent provided in section 958 in the case of stock in controlled foreign corporations (or foreign corporations which were controlled foreign corporations) and of property by reason of which a person is considered as owning such stock.”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years of foreign corporations beginning after December 31, 1962, and to taxable years of United States persons within which or with which such taxable years of such foreign corporations end.

SEC. 14. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE PROPERTY.

(a) IN GENERAL.—

(1) Part IV of subchapter P of chapter 1 (relating to special rules for determining capital gains and losses)

1 is amended by adding at the end thereof the following
2 new section:

3 **"SEC. 1245. GAIN FROM DISPOSITIONS OF CERTAIN DE-**
4 **PRECIABLE PROPERTY.**

5 **"(a) GENERAL RULE.—**

6 **"(1) ORDINARY INCOME.—**Except as otherwise
7 provided in this section, if section 1245 property is dis-
8 posed of after the date of the enactment of the Revenue
9 Act of 1962, the amount by which the lower of—

10 **"(A)** the recomputed basis of the property, or

11 **"(B) (i)** in the case of a sale, exchange, or
12 involuntary conversion, the amount realized, or

13 **"(ii)** in the case of any other disposition, the
14 fair market value of such property,

15 exceeds the adjusted basis of such property shall be
16 treated as gain from the sale or exchange of property
17 which is neither a capital asset nor property described in
18 section 1231. Such gain shall be recognized notwith-
19 standing any other provision of this subtitle.

20 **"(2) RECOMPUTED BASIS.—**For purposes of this
21 section, the term 'recomputed basis' means, with respect
22 to any property, its adjusted basis recomputed by adding
23 thereto all adjustments, for taxable years beginning after
24 December 31, 1961, reflected in such adjusted basis on
25 account of deductions (whether in respect of the same

or other property) allowed or allowable to the taxpayer or to any other person for depreciation, or for amortization under section 168. For purposes of the preceding sentence, if the taxpayer can establish by adequate records or other sufficient evidence that the amount allowed for depreciation, or for amortization under section 168, for any taxable year was less than the amount allowable, the amount added for such taxable year shall be the amount allowed.

“(3) SECTION 1245 PROPERTY.—For purposes of this section, the term ‘section 1245 property’ means any property (other than livestock) which is or has been property of a character subject to the allowance for depreciation provided in section 167 and is either—

“(A) personal property, or

“(B) other property (not including a building or its structural components) but only if such other property is tangible and has an adjusted basis in which there are reflected adjustments described in paragraph (2) for a period in which such property (or other property) —

“(i) was used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electri-

cal energy, gas, water, or sewage disposal services, or

“(ii) constituted research or storage facilities used in connection with any of the activities referred to in clause (i).

“(b) EXCEPTIONS AND LIMITATIONS.—

“(1) GIFTS.—Subsection (a) shall not apply to a disposition by gift.

“(2) TRANSFERS AT DEATH.—Except as provided in section 691 (relating to income in respect of a decedent), subsection (a) shall not apply to a transfer at death.

“(3) CERTAIN TAX-FREE TRANSACTIONS.—If the basis of property in the hands of a transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, 351, 361, 371 (a), 374 (a), 721, or 731, then the amount of gain taken into account by the transferor under subsection (a) (1) shall not exceed the amount of gain recognized to the transferor on the transfer of such property (determined without regard to this section). This paragraph shall not apply to a disposition to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter.

“(4) LIKE KIND EXCHANGES; INVOLUNTARY CON-

1 VERSIONS, ETC.—If property is disposed of and gain
 2 (determined without regard to this section) is not rec-
 3 ognized in whole or in part under section 1031 or 1033,
 4 then the amount of gain taken into account by the trans-
 5 feror under subsection (a) (1) shall not exceed the
 6 sum of—

7 “(A) the amount of gain recognized on such
 8 disposition (determined without regard to this sec-
 9 tion), plus

10 “(B) the fair market value of property acquired
 11 which is not section 1245 property and which is not
 12 taken into account under subparagraph (A).

13 “(5) SECTION 1071 AND 1081 TRANSACTIONS.—
 14 Under regulations prescribed by the Secretary or his
 15 delegate, rules consistent with paragraphs (3) and (4)
 16 of this subsection shall apply in the case of transactions
 17 described in section 1071 (relating to gain from sale
 18 or exchange to effectuate policies of FCC) or section
 19 1081 (relating to exchanges in obedience to SEC
 20 orders).

21 “(6) PROPERTY DISTRIBUTED BY A PARTNERSHIP
 22 TO A PARTNER.—

23 “(A) IN GENERAL.—For purposes of this sec-
 24 tion, the basis of section 1245 property distributed
 25 by a partnership to a partner shall be deemed to

1 be determined by reference to the adjusted basis of
2 such property to the partnership.

3 “(B) ADJUSTMENTS ADDED BACK.—In the
4 case of any property described in subparagraph
5 (A), for purposes of computing the recomputed
6 basis of such property the amount of the adjustments
7 added back for periods before the distribution by
8 the partnership shall be—

9 “(i) the amount of the gain to which sub-
10 section (a) would have applied if such property
11 had been sold by the partnership immediately
12 before the distribution at its fair market value
13 at such time, reduced by

14 “(ii) the amount of such gain to which
15 section 751 (b) applied.

16 “(c) ADJUSTMENTS TO BASIS.—The Secretary or his
17 delegate shall prescribe such regulations as he may deem
18 necessary to provide for adjustments to the basis of property
19 to reflect gain recognized under subsection (a).

20 “(d) APPLICATION OF SECTION.—This section shall
21 apply notwithstanding any other provision of this subtitle.”

22 (2) The table of sections for such part IV is
23 amended by adding at the end thereof the following:

 “Sec. 1245. Gain from dispositions of certain depreciable
 property.”

1 (b) CHANGE IN METHOD OF DEPRECIATION.—Sub-
2 section (e) of section 167 (relating to depreciation) is
3 amended to read as follows:

4 “(e) CHANGE IN METHOD.—

5 “(1) CHANGE FROM DECLINING BALANCE
6 METHOD.—In the absence of an agreement under sub-
7 section (d) containing a provision to the contrary, a
8 taxpayer may at any time elect in accordance with regu-
9 lations prescribed by the Secretary or his delegate to
10 change from the method of depreciation described in sub-
11 section (b) (2) to the method described in subsection
12 (b) (1).

13 “(2) CHANGE WITH RESPECT TO SECTION 1245
14 PROPERTY.—A taxpayer may, within such period after
15 the date of the enactment of the Revenue Act of 1962
16 and in such manner as the Secretary or his delegate
17 shall by regulations prescribe, elect to change his method
18 of depreciation in respect of section 1245 property (as
19 defined in section 1245 (a) (3)) from any declining
20 balance or sum of the years-digits method to the straight
21 line method. An election may be made under this
22 paragraph notwithstanding any provision to the con-
23 trary in an agreement under subsection (d).”

1 (c) SALVAGE VALUE OF PERSONAL PROPERTY.—

2 (1) AMOUNT TAKEN INTO ACCOUNT.—Section
3 167 (relating to depreciation) is amended by redesignat-
4 ing subsections (f), (g), and (h) as (g), (h), and
5 (i), respectively, and by inserting after subsection (e)
6 the following new subsection:

7 “(f) SALVAGE VALUE.—

8 “(1) GENERAL RULE.—Under regulations pre-
9 scribed by the Secretary or his delegate, a taxpayer may,
10 for purposes of computing the allowance under sub-
11 section (a) with respect to personal property, reduce
12 the amount taken into account as salvage value by an
13 amount which does not exceed 10 percent of the basis
14 of such property (as determined under subsection (g)
15 as of the time as of which such salvage value is required
16 to be determined).

17 “(2) PERSONAL PROPERTY DEFINED.—For pur-
18 poses of this subsection, the term ‘personal property’
19 means depreciable personal property (other than live-
20 stock) with a useful life of 3 years or more acquired after
21 the date of the enactment of the Revenue Act of 1962.”

22 (2) CONFORMING AMENDMENTS.—

23 (A) Sections 179(d)(5) and 642(e) are
24 each amended by striking out “167(g)” and in-
25 serting in lieu thereof “167(h)”.

1 (B) Section 179 (d) (8) is amended by strik-
 2 ing out “167 (f)” and inserting in lieu thereof
 3 “167 (g)”.

4 (d) SPECIAL RULE FOR CHARITABLE CONTRIBUTIONS
 5 OF SECTION 1245 PROPERTY.—Section 170 (relating to
 6 charitable, etc., contributions and gifts) is amended by re-
 7 designating subsections (e) and (f) as (f) and (g), re-
 8 spectively, and by inserting after subsection (d) the follow-
 9 ing new subsection:

10 “(e) SPECIAL RULE FOR CHARITABLE CONTRIBU-
 11 TIONS OF SECTION 1245 PROPERTY.—The amount of any
 12 charitable contribution taken into account under this section
 13 shall be reduced by the amount which would have been
 14 treated as gain to which section 1245 (a) applies if the prop-
 15 erty contributed had been sold at its fair market value
 16 (determined at the time of such contribution).”

17 (e) TECHNICAL AMENDMENTS.—

18 (1) SPECIAL RULE FOR PARTNERSHIPS.—Section
 19 751 (c) (relating to definition of “unrealized receiv-
 20 ables” for purposes of subchapter K) is amended by
 21 adding after paragraph (2) the following:

22 “For purposes of this section and sections 731, 736, and
 23 741, such term also includes section 1245 property (as de-
 24 fined in section 1245 (a) (3)), but only to the extent of the

1 amount which would be treated as gain to which section
 2 1245 (a) would apply if (at the time of the transaction de-
 3 scribed in this section or section 731, 736, or 741, as the
 4 case may be) such property had been sold by the partner-
 5 ship at its fair market value.”

6 (2) CORPORATE DISTRIBUTION OF PROPERTY.—

7 Subsections (b) and (d) of section 301 (relating to
 8 amount distributed) are each amended by striking out
 9 “subsection (b) or (c) of section 311” and inserting in
 10 lieu thereof “subsection (b) or (c) of section 311 or
 11 under section 1245 (a)”.

12 (3) EFFECT ON EARNINGS AND PROFITS.—Section
 13 312 (c) (3) (relating to adjustments of earnings and
 14 profits) is amended by striking out “subsection (b)
 15 or (c) of section 311” and inserting in lieu thereof
 16 “subsection (b) or (c) of section 311 or under sec-
 17 tion 1245 (a)”.

18 (4) COLLAPSIBLE CORPORATIONS.—Section 341
 19 (e) (relating to collapsible corporations) is amended
 20 by inserting after paragraph (11) the following new
 21 paragraph:

22 “(12) NONAPPLICATION OF SECTION 1245(a).—
 23 For purposes of this subsection, the determination of
 24 whether gain from the sale or exchange of property
 25 would under any provision of this chapter be considered

1 as gain from the sale or exchange of property which is
 2 neither a capital asset nor property described in section
 3 1231 (b) shall be made without regard to the applica-
 4 tion of section 1245 (a)."

5 (5) INSTALLMENT OBLIGATIONS IN CERTAIN
 6 LIQUIDATIONS.—

7 (A) Section 453 (d) (4) (A) (relating to
 8 distribution of installment obligations in section 332
 9 liquidations) is amended by adding at the end there-
 10 of the following new sentence: "If the basis of the
 11 property of the liquidating corporation in the hands
 12 of the distributee is determined under section 334
 13 (b) (2) then the preceding sentence shall not apply
 14 to the extent that under paragraph (1) gain to the
 15 distributing corporation would be considered as gain
 16 to which section 1245 (a) applies."

17 (B) Section 453 (d) (4) (B) (relating to dis-
 18 tribution of installment obligations in liquidations
 19 to which section 337 applies) is amended by adding
 20 at the end thereof the following new sentence: "The
 21 preceding sentence shall not apply to the extent that
 22 under paragraph (1) gain to the distributing cor-
 23 poration would be considered as gain to which sec-
 24 tion 1245 (a) applies."

25 (f) EFFECTIVE DATE.—The amendments made by this

1 section shall apply to taxable years beginning after December
2 31, 1961, and ending after the date of the enactment of this
3 Act.

4 **SEC. 15. FOREIGN INVESTMENT COMPANIES.**

5 (a) **TREATMENT OF SALE OF STOCK OF FOREIGN**
6 **INVESTMENT COMPANIES.—**

7 (1) **IN GENERAL.**—Part IV of subchapter P of
8 chapter 1 (relating to special rules for determining
9 capital gains and losses) is amended by adding after
10 section 1245 (as added by section 14 of this Act) the
11 following new sections:

12 **“SEC. 1246. GAIN ON FOREIGN INVESTMENT COMPANY**
13 **STOCK.**

14 **“(a) TREATMENT OF GAIN AS ORDINARY INCOME.—**

15 **“(1) GENERAL RULE.**—In the case of a sale or
16 exchange after December 31, 1962, of stock in a foreign
17 corporation which was a foreign investment company
18 (as defined in subsection (b)) at any time during the
19 period during which the taxpayer held such stock, any
20 gain shall be treated as gain from the sale or exchange
21 of property which is not a capital asset, to the extent
22 of the taxpayer's ratable share of the earnings and
23 profits of such corporation accumulated for taxable years
24 beginning after December 31, 1962.

25 **“(2) RATABLE SHARE.**—For purposes of this sec-

tion, the taxpayer's ratable share shall be determined under regulations prescribed by the Secretary or his delegate, but shall include only his ratable share of the accumulated earnings and profits of such corporation—

“(A) for the period during which the taxpayer held such stock, but

“(B) excluding such earnings and profits which were taxed to such taxpayer under section 951 or under section 551.

“(3) TAXPAYER TO ESTABLISH EARNINGS AND PROFITS.—Unless the taxpayer establishes the amount of the accumulated earnings and profits of the foreign investment company and the ratable share thereof for the period during which the taxpayer held such stock, all the gain from the sale or exchange of stock in such company shall be considered as gain from the sale or exchange of property which is not a capital asset.

“(4) HOLDING PERIOD OF STOCK MUST BE MORE THAN 6 MONTHS.—This section shall not apply with respect to the sale or exchange of stock where the holding period of such stock as of the date of such sale or exchange is 6 months or less.

“(b) DEFINITION OF FOREIGN INVESTMENT COMPANY.—For purposes of this section, the term ‘foreign investment company’ means any foreign corporation—

1 “(1) registered under the Investment Company
2 Act of 1940, as amended (15 U.S.C. 80a-1 to 80b-2),
3 either as a management company or as a unit invest-
4 ment trust, or

5 “(2) engaged (or holding itself out as being
6 engaged) primarily in the business of investing, rein-
7 vesting, or trading in securities (within the meaning of
8 section 3 (a) (1) of such Act) at a time when more
9 than 50 percent of the total combined voting power of
10 all classes of stock entitled to vote, or of the total value
11 of shares of all classes of stock, was held, directly or
12 indirectly (within the meaning of section 954 (a)), by
13 United States persons (as defined in section 7701
14 (a) (30)).

15 “(c) STOCK HAVING TRANSFERRED OR SUBSTITUTED
16 BASIS.—To the extent provided in regulations prescribed
17 by the Secretary or his delegate, stock in a foreign corpora-
18 tion, the basis of which (in the hands of the taxpayer selling
19 or exchanging such stock) is determined by reference to the
20 basis (in the hands of such taxpayer or any other person)
21 of stock in a foreign investment company, shall be treated
22 as stock of a foreign investment company and held by the
23 taxpayer throughout the holding period for such stock (deter-
24 mined under section 1223).

1 “(d) RULES RELATING TO ENTITIES HOLDING FOR-
2 EIGN INVESTMENT COMPANY STOCK.—To the extent pro-
3 vided in regulations prescribed by the Secretary or his
4 delegate—

5 “(1) trust certificates of a trust to which section
6 677 (relating to income for benefit of grantor) applies,
7 and

8 “(2) stock of a domestic corporation,
9 shall be treated as stock of a foreign investment company and
10 held by the taxpayer throughout the holding period for such
11 certificates or stock (determined under section 1223) in the
12 same proportion that the investment in stock in a foreign
13 investment company by the trust or domestic corporation
14 bears to the total assets of such trust or corporation.

15 “(e) RULES RELATING TO STOCK ACQUIRED FROM A
16 DECEDENT.—

17 “(1) BASIS.—In the case of stock of a foreign
18 investment company acquired by bequest, devise, or
19 inheritance (or by the decedent's estate) from a dece-
20 dent dying after December 31, 1962, the basis deter-
21 mined under section 1014 shall be reduced (but not
22 below the adjusted basis of such stock in the hands of
23 the decedent immediately before his death) by the
24 amount of the decedent's ratable share of the accumu-

1 lated earnings and profits of such company. Any
2 stock so acquired shall be treated as stock described in
3 subsection (c).

4 “(2) DEDUCTION FOR ESTATE TAX.—If stock to
5 which subsection (a) applies is acquired from a dece-
6 dent, the taxpayer shall, under regulations prescribed
7 by the Secretary or his delegate, be allowed (for the
8 taxable year of the sale or exchange) a deduction from
9 gross income equal to that portion of the decedent’s
10 estate tax deemed paid which is attributable to the excess
11 of (A) the value at which such stock was taken into
12 account for purposes of determining the value of the
13 decedent’s gross estate, over (B) the value at which
14 it would have been so taken into account if such value
15 had been reduced by the amount described in para-
16 graph (1).

17 “(f) INFORMATION WITH RESPECT TO CERTAIN
18 FOREIGN INVESTMENT.—Every United States person who,
19 on the last day of the taxable year of a foreign investment
20 company beginning after December 31, 1962, owns 5 per-
21 cent or more in value of the stock of such company shall
22 furnish with respect to such company such information as the
23 Secretary or his delegate shall by regulations prescribe.

24 “(g) CROSS REFERENCE.—

**“For special rules relating to the earnings and profits
of foreign investment companies, see section 312(l).**

1 "SEC. 1247. ELECTION BY FOREIGN INVESTMENT COM-
2 PANIES TO DISTRIBUTE INCOME CUR-
3 RENTLY.

4 "(a) ELECTION BY FOREIGN INVESTMENT COM-
5 PANY.—

6 "(1) IN GENERAL.—If a foreign investment com-
7 pany which is described in section 1246 (b) (1) elects
8 (in the manner provided in regulations prescribed by
9 the Secretary or his delegate) on or before December
10 31, 1962, with respect to each taxable year beginning
11 after December 31, 1962, to—

12 "(A) distribute to its shareholders 90 percent
13 or more of what its taxable income would be if it
14 were a domestic corporation;

15 "(B) designate in a written notice mailed to
16 its shareholders at any time before the expiration
17 of 30 days after the close of its taxable year the
18 pro rata amount of the excess (determined as if such
19 corporation were a domestic corporation) of the net
20 long-term capital gains over the net short-term
21 capital losses; and the portion thereof which is being
22 distributed; and

23 "(C) provide such information as the Secre-
24 tary or his delegate deems necessary to carry out the
25 purposes of this section,

1 then section 1246 shall not apply with respect to the
2 qualified shareholders of such company during any
3 taxable year to which such election applies.

4 “(2) SPECIAL RULES.—

5 “(A) COMPUTATION OF TAXABLE INCOME.—

6 For purposes of paragraph (1) (A), the taxable
7 income of the company shall be computed without
8 regard to—

9 “(i) the excess of capital gains over losses
10 referred to in paragraph (1) (B),

11 “(ii) section 172 (relating to net operating
12 losses), and

13 “(iii) any deduction provided by part VIII
14 of subchapter B (other than the deduction pro-
15 vided by section 248, relating to organizational
16 expenditures).

17 “(B) DISTRIBUTIONS AFTER THE CLOSE OF
18 THE TAXABLE YEAR.—For purposes of paragraph
19 (1) (A), a distribution made after the close of the
20 taxable year and on or before the 15th day of the
21 third month of the next taxable year shall be treated
22 as distributed during the taxable year to the extent
23 elected by the company (in accordance with regu-
24 lations prescribed by the Secretary or his delegate)
25 on or before the 15th day of such third month.

1 “(C) CARRYOVER OF CAPITAL LOSSES FROM
2 NONELECTION YEARS DENIED.—In computing the
3 excess of capital gains over losses referred to in
4 paragraph (1) (B), section 1212 shall not apply
5 to losses incurred in or with respect to taxable years
6 before the first taxable year to which the election
7 applies.

8 “(b) YEARS TO WHICH ELECTION APPLIES.—The
9 election of any foreign investment company under this sec-
10 tion shall terminate as of the close of the taxable year pre-
11 ceding its first taxable year in which any of the following
12 occurs:

13 “(1) the company fails to comply with the provi-
14 sions of subparagraph (A), (B), or (C) of subsection
15 (a) (1), unless it is shown that such failure is due to
16 reasonable cause and not due to willful neglect,

17 “(2) the company is a foreign personal holding
18 company, or

19 “(3) the company is not a foreign investment com-
20 pany which is described in section 1246 (b) (1).

21 “(c) QUALIFIED SHAREHOLDERS.—For purposes of
22 this section—

23 “(1) IN GENERAL.—The term ‘qualified share-
24 holder’ means any shareholder who is a United States

1 person, other than a shareholder described in paragraph
2 (2).

3 “(2) CERTAIN UNITED STATES PERSONS EX-
4 CLUDED FROM DEFINITION.—A United States person
5 shall not be treated as a qualified shareholder for the
6 taxable year if for such taxable year (or for any prior
7 taxable year) he did not include, in computing his long-
8 term capital gains in his return for such taxable year,
9 the amount designated by such company pursuant to
10 subsection (a) (1) (B) as his share of the undistributed
11 capital gains of such company for its taxable year end-
12 ing within or with such taxable year of the taxpayer.
13 The preceding sentence shall not apply with respect
14 to any failure by the taxpayer to treat an amount as
15 provided therein if the taxpayer shows that such failure
16 was due to reasonable cause and not due to willful
17 neglect.

18 “(d) ADJUSTMENTS.—Under regulations prescribed
19 by the Secretary or his delegate, proper adjustment shall be
20 made—

21 “(1) in the earnings and profits of the electing
22 foreign investment company, and

23 “(2) the adjusted basis of stock of such company
24 held by qualified shareholders,

1 to reflect the inclusion in gross income by such shareholders
2 of undistributed capital gains.

3 “(e) LOSS ON SALE OR EXCHANGE OF CERTAIN STOCK
4 HELD LESS THAN 6 MONTHS.—If—

5 “(1) under this section, any qualified shareholder
6 treats any amount designated under subsection (a) (1)
7 (B) with respect to a share of stock as long-term capital
8 gain, and

9 “(2) such share is held by the taxpayer for less
10 than 6 months,

11 then any loss on the sale or exchange of such share shall,
12 to the extent of the amount described in paragraph (1),
13 be treated as loss from the sale or exchange of a capital
14 asset held for more than 6 months.”

15 (2) The table of sections for such part IV is
16 amended by adding at the end thereof the following:

“Sec. 1246. Gain on foreign investment company.

“Sec. 1247. Election by foreign investment companies to
distribute income currently.”

17 (b) CONFORMING AMENDMENTS.—

18 (1) EARNINGS AND PROFITS OF FOREIGN IN-
19 VESTMENT COMPANIES.—Section 312 (relating to
20 effect on earnings and profits) is amended by adding
21 after subsection (k) the following new subsection:

1 “(1) EARNINGS AND PROFITS OF FOREIGN INVEST-
2 MENT COMPANIES.—

3 “(1) ALLOCATION WITHIN AFFILIATED GROUP.—

4 In the case of a sale or exchange of stock in a foreign
5 investment company (as defined in section 1246 (b))
6 by a United States person (as defined in section 7701
7 (a) (30)), if such company is a member of an affiliated
8 group, then the accumulated earnings and profits of all
9 members of such affiliated group shall be allocated, under
10 regulations prescribed by the Secretary or his delegate,
11 in such manner as is proper to carry out the purposes of
12 section 1246.

13 “(2) AFFILIATED GROUP DEFINED.—For purposes
14 of paragraphs (1) and (2) of this subsection, the term
15 ‘affiliated group’ has the meaning assigned to such term
16 by section 1504 (a) ; except that (A) ‘more than 50
17 percent’ shall be substituted for ‘80 percent or more’,
18 and (B) all corporations shall be treated as includible
19 corporations (without regard to the provisions of
20 section 1504 (b)).

21 “(3) PARTIAL LIQUIDATIONS AND REDEMP-
22 TIONS.—

23 “(A) IN GENERAL.—If a foreign investment
24 company (as defined in section 1246) distributes
25 amounts in partial liquidation or in a redemption to

1 which section 302 (a) or 303 applies, the part of
2 such distribution which is properly chargeable to
3 earnings and profits shall be an amount which is
4 not in excess of the ratable share of the earnings
5 and profits of the company accumulated after
6 February 28, 1913, attributable to the stock so
7 redeemed.

8 “(B) EFFECTIVE DATE.—Subparagraph (A)
9 shall apply only with respect to distributions made
10 after December 31, 1962.”

11 (2) SALE OR EXCHANGE OF INTEREST IN PART-
12 NERSHIP.—Section 751 (d) (2) (relating to inventory
13 items which have appreciated substantially in value) is
14 amended by striking out “and” at the end of subpara-
15 graph (B), and by striking out subparagraph (C) and
16 inserting in lieu thereof the following new subparagraphs:

17 “(C) any other property of the partnership
18 which, if sold or exchanged by the partnership,
19 would result in a gain taxable under subsection (a)
20 of section 1246 (relating to gain on foreign invest-
21 ment company stock), and

22 “(D) any other property held by the partner-
23 ship which, if held by the selling or distributee part-
24 ner, would be considered property of the type
25 described in subparagraph (A), (B), or (C).”

1 (3) **HOLDING PERIOD OF PROPERTY.**—Section
2 1223 (relating to holding period of property) is amend-
3 ed by redesignating paragraph (10) as paragraph (11)
4 and inserting after paragraph (9) the following para-
5 graph:

6 “(10) In determining the period for which the
7 taxpayer has held trust certificates of a trust to which
8 subsection (d) of section 1246 applies, or the period
9 for which the taxpayer has held stock in a corporation
10 to which subsection (d) of section 1246 applies, there
11 shall be included the period for which the trust or cor-
12 poration (as the case may be) held the stock of foreign
13 investment companies.”

14 (c) **EFFECTIVE DATE.**—The amendments made by
15 this section shall apply with respect to taxable years begin-
16 ning after December 31, 1962.

17 **SEC. 16. GAIN FROM CERTAIN SALES OR EXCHANGES OF**
18 **STOCK IN CERTAIN FOREIGN CORPORATIONS.**

19 (a) **TREATMENT OF GAIN FROM THE REDEMPTION,**
20 **CANCELLATION, OR SALE OF STOCK IN CERTAIN FOREIGN**
21 **CORPORATIONS.**—Part IV of subchapter P of chapter 1
22 (relating to special rules for determining capital gains and
23 losses) is amended by adding after section 1247 (as added
24 by section 15 of this Act) the following new section:

1 “SEC. 1248. GAIN FROM CERTAIN SALES OR EXCHANGES
2 OF STOCK IN CERTAIN FOREIGN CORPORA-
3 TIONS.

4 “(a) REDEMPTIONS AND LIQUIDATIONS.—If a foreign
5 corporation redeems its stock in an exchange to which sec-
6 tion 302 (a) applies, or if a foreign corporation cancels its
7 stock in a complete or partial liquidation in an exchange to
8 which section 331 applies, then the gain of a United States
9 person (as defined in section 7701 (a) (30)) from the ex-
10 change of such stock shall be included in the gross income
11 of such person as a dividend, to the extent of such person’s
12 proportionate share of the earnings and profits of the foreign
13 corporation accumulated after February 28, 1913.

14 “(b) SALES AND OTHER EXCHANGES.—If a United
15 States person (as defined in section 7701 (a) (30)) sells or
16 exchanges stock in a foreign corporation, then the gain
17 recognized on the sale or exchange of such stock shall be
18 considered as gain from the sale or exchange of property
19 which is not a capital asset, to the extent of such person’s
20 proportionate share of the earnings and profits of the foreign
21 corporation accumulated during the period the stock sold or
22 exchanged was held by such person.

1 “(c) LIMITATIONS.—

2 “(1) CONTROLLED FOREIGN CORPORATIONS.—

3 Subsections (a) and (b) shall apply only if the foreign
4 corporation the stock of which is sold or exchanged (A)
5 is a controlled foreign corporation (as defined in section
6 954) at the time of the sale or exchange, or (B) was
7 such a controlled foreign corporation at any time during
8 the 5-year period ending on the date of the sale or
9 exchange.

10 “(2) 10-PERCENT OWNERSHIP.—Subsections (a)
11 and (b) shall apply only to a United States person who
12 can be considered, by applying the rules of constructive
13 ownership of section 955(b), as being the owner,
14 directly or indirectly, of 10 percent or more of the total
15 combined voting power of all classes of stock entitled
16 to vote of the foreign corporation at the time of the sale
17 or exchange, or at any time during the 5-year period
18 ending on the date of the sale or exchange.

19 “(3) ELIMINATION FROM EARNINGS AND PROFITS
20 OF AMOUNTS INCLUDED IN GROSS INCOME UNDER
21 SECTION 951.—In determining the amount to be con-
22 sidered a dividend under subsection (a), or as gain from
23 the sale or exchange of property which is not a capital

1 asset under subsection (b), the United States person's
2 proportionate share of earnings and profits of the foreign
3 corporation shall be reduced by the amount previously
4 included in the gross income of such person under section
5 951, with respect to the stock sold or exchanged, but
6 only to the extent such amount did not result in an
7 exclusion from gross income under section 956.

8 “(4) REDEMPTIONS TO PAY DEATH TAXES.—Sub-
9 sections (a) and (b) shall not apply to distributions to
10 which section 303 (relating to distributions in re-
11 demption of stock to pay death taxes) applies.

12 “(5) ADDITIONAL CONSIDERATION IN CERTAIN
13 REORGANIZATIONS.—Subsection (b) shall not apply to
14 gain recognized on exchanges to which section 356 (re-
15 lating to receipt of additional consideration in certain
16 reorganizations) applies.

17 “(6) TREATMENT OF AMOUNTS WHICH ARE ORDI-
18 NARY INCOME, ETC., UNDER OTHER PROVISIONS.—Sub-
19 sections (a) and (b) shall not apply with respect to any
20 amount to the extent that such amount is, under any
21 other provision of this title, treated as—

22 “(A) a dividend,

1 “(B) gain from the sale of an asset which is
2 not a capital asset, or

3 “(C) gain from the sale of an asset held for not
4 more than 6 months.

5 “(d) TAXPAYER TO ESTABLISH EARNINGS AND
6 PROFITS.—Unless the taxpayer establishes the amount of
7 the earnings and profits of the foreign corporation to be taken
8 into account under subsections (a) and (b), all gain from
9 the sale or exchange shall be considered a dividend under
10 subsection (a), or as gain from the sale or exchange of
11 property which is not a capital asset under subsection (b),
12 whichever applies.”

13 (b) CLERICAL AMENDMENT.—The table of sections for
14 such part IV is amended by adding at the end thereof the
15 following:

“Sec. 1248. Gain from certain sales or exchanges of stock
in certain foreign corporations.”

16 (c) EFFECTIVE DATE.—The amendments made by this
17 section shall apply with respect to sales or exchanges oc-
18 ccurring after the date of the enactment of this Act.

1 **SEC. 17. TAX TREATMENT OF COOPERATIVES AND**
 2 **PATRONS.**

3 (a) **IN GENERAL.**—Chapter 1 (relating to normal
 4 taxes and surtaxes) is amended by adding at the end thereof
 5 the following new subchapter:

6 **“Subchapter T—Cooperatives and Their Patrons**

“Part I. Tax treatment of cooperatives.

“Part II. Tax treatment by patrons of patronage dividends.

“Part III. Definitions; special rules.

7 **“PART I—TAX TREATMENT OF COOPERATIVES**

“Sec. 1381. Organizations to which part applies.

“Sec. 1382. Taxable income of cooperatives.

“Sec. 1383. Computation of tax where cooperative redeems
 nonqualified written notices of allocation.

8 **“SEC. 1381. ORGANIZATIONS TO WHICH PART APPLIES.**

9 “(a) **IN GENERAL.**—This part shall apply to—

10 “(1) any organization exempt from tax under sec-
 11 tion 521 (relating to exemption of farmers’ cooperatives
 12 from tax), and

13 “(2) any corporation operating on a cooperative
 14 basis other than an organization—

15 “(A) which is exempt from tax under this
 16 chapter,

1 “(B) which is subject to the provisions of—

2 “(i) part II of subchapter H (relating
3 to mutual savings banks, etc.), or

4 “(ii) subchapter L (relating to insurance
5 companies), or

6 “(C) which is engaged in furnishing electric
7 energy, or providing telephone service, to persons
8 in rural areas.

9 “(b) **TAX ON CERTAIN FARMERS’ COOPERATIVES.**—

10 An organization described in subsection (a) (1) shall be
11 subject to the taxes imposed by section 11 or 1201.

12 **“SEC. 1382. TAXABLE INCOME OF COOPERATIVES.**

13 “(a) **GROSS INCOME.**—Except as provided in subsec-
14 tion (b), the gross income of any organization to which this
15 part applies shall be determined without any adjustment
16 (as a reduction in gross receipts, an increase in cost of goods
17 sold, or otherwise) by reason of any allocation or distribution
18 to a patron out of the net earnings of such organization.

19 “(b) **PATRONAGE DIVIDENDS.**—In determining the
20 taxable income of an organization to which this part applies,
21 there shall not be taken into account amounts paid during
22 the payment period for the taxable year—

23 “(1) as patronage dividends (as defined in section
24 1388 (a)), to the extent paid in money, qualified writ-
25 ten notices of allocation (as defined in section 1388

(c)), or other property (except nonqualified written notices of allocation (as defined in section 1388 (d))) with respect to patronage occurring during such taxable year; or

“(2) in money or other property (except written notices of allocation) in redemption of a nonqualified written notice of allocation which was paid as a patronage dividend during the payment period for the taxable year during which the patronage occurred.

For purposes of this title, any amount not taken into account under the preceding sentence shall be treated in the same manner as an item of gross income and as a deduction therefrom.

“(c) DEDUCTION FOR NONPATRONAGE DISTRIBUTIONS, ETC.—In determining the taxable income of an organization described in section 1381 (a) (1), there shall be allowed as a deduction (in addition to other deductions allowable under this chapter) —

“(1) amounts paid during the taxable year as dividends on its capital stock; and

“(2) amounts paid during the payment period for the taxable year—

“(A) in money, qualified written notices of allocation, or other property (except nonqualified written notices of allocation) on a patronage basis

1 to patrons with respect to its earnings during such
2 taxable year which are derived from business done
3 for the United States or any of its agencies or from
4 sources other than patronage, or

5 “(B) in money or other property (except writ-
6 ten notices of allocation) in redemption of a non-
7 qualified written notice of allocation which was paid,
8 during the payment period for the taxable year dur-
9 ing which the earnings were derived, on a patron-
10 age basis to a patron with respect to earnings de-
11 rived from business or sources described in subpara-
12 graph (A).

13 “(d) PAYMENT PERIOD FOR EACH TAXABLE YEAR.—
14 For purposes of subsections (b) and (c) (2), the payment
15 period for any taxable year is the period beginning with the
16 first day of such taxable year and ending with the fifteenth
17 day of the ninth month following the close of such year.

18 “(e) PRODUCTS MARKETING UNDER POOLING AR-
19 RANGEMENTS.—For purposes of subsection (b), in the case
20 of a pooling arrangement for the marketing of products, the
21 patronage shall (to the extent provided in regulations pre-
22 scribed by the Secretary or his delegate) be treated as
23 patronage occurring during the taxable year in which the
24 pool closes.

25 “(f) TREATMENT OF EARNINGS RECEIVED AFTER

1 PATRONAGE OCCURRED.—If any portion of the earnings
 2 from business done with or for patrons is includible in the
 3 organization's gross income for a taxable year after the
 4 taxable year during which the patronage occurred, then for
 5 purposes of applying subsection (b) to such portion the
 6 patronage shall, to the extent provided in regulations pre-
 7 scribed by the Secretary or his delegate, be considered to
 8 have occurred during the taxable year of the organization
 9 during which such earnings are includible in gross income.

10 **"SEC. 1383. COMPUTATION OF TAX WHERE COOPERATIVE**
 11 **REDEEMS NONQUALIFIED WRITTEN NO-**
 12 **TICES OF ALLOCATION.**

13 **"(a) GENERAL RULE.**—If, under section 1382 (b) (2)
 14 or (c) (2) (B), a deduction is allowable to an organization
 15 for the taxable year for amounts paid in redemption of non-
 16 qualified written notices of allocation, then the tax imposed
 17 by this chapter on such organization for the taxable year
 18 shall be the lesser of the following:

19 **"(1)** the tax for the taxable year computed with
 20 such deduction; or

21 **"(2)** an amount equal to—

22 **"(A)** the tax for the taxable year computed
 23 without such deduction, minus

24 **"(B)** the decrease in tax under this chapter
 25 for any prior taxable year (or years) which would

1 result solely from treating such nonqualified written
2 notices of allocation as qualified written notices of
3 allocation.

4 “(b) SPECIAL RULES.—

5 “(1) If the decrease in tax ascertained under sub-
6 section (a) (2) (B) exceeds the tax for the taxable year
7 (computed without the deduction described in subsection
8 (a)) such excess shall be considered to be a payment
9 of tax on the last day prescribed by law for the payment
10 of tax for the taxable year, and shall be refunded or
11 credited in the same manner as if it were an overpay-
12 ment for such taxable year.

13 “(2) For purposes of determining the decrease in
14 tax under subsection (a) (2) (B), the stated dollar
15 amount of any nonqualified written notice of allocation
16 which is to be treated under such subsection as a quali-
17 fied written notice of allocation shall be the amount paid
18 in redemption of such written notice of allocation which
19 is allowable as a deduction under section 1382 (b) (2)
20 or (c) (2) (B) for the taxable year.

21 “(3) If the tax imposed by this chapter for the tax-
22 able year is the amount determined under subsection
23 (a) (2), then the deduction described in subsection (a)
24 shall not be taken into account for any purpose of this
25 subtitle other than for purposes of this section.

1 **"PART II—TAX TREATMENT BY PATRONS OF PA-**
2 **TRONAGE DIVIDENDS**

"Sec. 1385. Amounts includible in patron's gross income.

3 **"SEC. 1385. AMOUNTS INCLUDIBLE IN PATRON'S GROSS**
4 **INCOME.**

5 “(a) **GENERAL RULE.**—Except as otherwise provided
6 in subsection (b), each person shall include in gross
7 income—

8 “(1) the amount of any patronage dividend which
9 is paid in money, a qualified written notice of allocation,
10 or other property (except a nonqualified written notice
11 of allocation), and which is received by him during the
12 taxable year from an organization described in section
13 1381 (a), and

14 “(2) any amount, described in section 1382 (c) (2)
15 (A) (relating to certain nonpatronage distributions by
16 tax-exempt farmers' cooperatives), which is paid in
17 money, a qualified written notice of allocation, or other
18 property (except a nonqualified written notice of alloca-
19 tion), and which is received by him during the taxable
20 year from an organization described in section 1381 (a)
21 (1).

22 “(b) **EXCLUSION FROM GROSS INCOME.**—Under regu-
23 lations prescribed by the Secretary or his delegate, the

1 amount of any patronage dividend, and any amount re-
 2 ceived on the redemption, sale, or other disposition of a non-
 3 qualified written notice of allocation which was paid as a
 4 patronage dividend, shall not be included in gross income to
 5 the extent that such amount—

6 “(1) is properly taken into account as an adjust-
 7 ment to basis of property, or

8 “(2) is attributable to personal, living, or family
 9 items.

10 “(c) TREATMENT OF CERTAIN NONQUALIFIED WRIT-
 11 TEN NOTICES OF ALLOCATION.—

12 “(1) APPLICATION OF SUBSECTION.—This sub-
 13 section shall apply to any nonqualified written notice of
 14 allocation which—

15 “(A) was paid as a patronage dividend, or

16 “(B) was paid by an organization described in
 17 section 1381 (a) (1) on a patronage basis with re-
 18 spect to earnings derived from business or sources
 19 described in section 1382 (c) (2) (A).

20 “(2) BASIS; AMOUNT OF GAIN.—In the case of
 21 any nonqualified written notice of allocation to which
 22 this subsection applies, for purposes of this chapter—

23 “(A) the basis of such written notice of alloca-
 24 tion in the hands of the patron to whom such written
 25 notice of allocation was paid shall be zero,

“(B) the basis of such written notice of allocation which was acquired from a decedent shall be its basis in the hands of the decedent, and

“(C) gain on the redemption, sale, or other disposition of such written notice of allocation by any person shall, to the extent that the stated dollar amount of such written notice of allocation exceeds its basis, be considered as gain from the sale or exchange of property which is not a capital asset.

“PART III—DEFINITIONS; SPECIAL RULES

“Sec. 1388. Definitions; special rules.

“SEC. 1388. DEFINITIONS; SPECIAL RULES.

“(a) PATRONAGE DIVIDEND.—For purposes of this subchapter, the term ‘patronage dividend’ means an amount paid to a patron by an organization to which part I of this subchapter applies—

“(1) on the basis of quantity or value of business done with or for such patron,

“(2) under an obligation of such organization to pay such amount, which obligation existed before the organization received the amount so paid, and

“(3) which is determined by reference to the net earnings of the organization from business done with or for its patrons.

1 Such term does not include any amount paid to a patron to
2 the extent that (A) such amount is out of earnings other
3 than from business done with or for patrons, or (B)
4 such amount is out of earnings from business done with or
5 for other patrons to whom no amounts are paid, or to whom
6 smaller amounts are paid, with respect to substantially
7 identical transactions.

8 “(b) WRITTEN NOTICE OF ALLOCATION.—For pur-
9 poses of this subchapter, the term ‘written notice of alloca-
10 tion’ means any capital stock, revolving fund certificate,
11 retain certificate, certificate of indebtedness, letter of advice,
12 or other written notice, which discloses to the recipient the
13 stated dollar amount allocated to him by the organization
14 and the portion thereof, if any, which constitutes a patronage
15 dividend.

16 “(c) QUALIFIED WRITTEN NOTICE OF ALLOCATION.—

17 “(1) DEFINED.—For purposes of this subchapter,
18 the term ‘qualified written notice of allocation’ means—

19 “(A) a written notice of allocation which may
20 be redeemed in cash at its stated dollar amount at
21 any time within a period beginning on the date such
22 written notice of allocation is paid and ending not
23 earlier than 90 days from such date, but only if the
24 distributee receives written notice of the right of

1 redemption at the time he receives such written no-
2 tice of allocation; and

3 “(B) a written notice of allocation which the
4 distributee has consented, in the manner provided
5 in paragraph (2), to take into account at its stated
6 dollar amount as provided in section 1385 (a).

7 “(2) MANNER OF OBTAINING CONSENT.—A dis-
8 tributee shall consent to take a written notice of alloca-
9 tion into account as provided in paragraph (1) (B)
10 only by—

11 “(A) making such consent in writing, or

12 “(B) obtaining or retaining membership in the
13 organization after—

14 “(i) such organization has adopted (after
15 the date of the enactment of the Revenue Act
16 of 1962) a bylaw providing that membership
17 in the organization constitutes such consent, and

18 “(ii) he has received a written notifica-
19 tion and copy of such bylaw.

20 “(3) PERIOD FOR WHICH CONSENT IS EFFEC-
21 TIVE.—

22 “(A) GENERAL RULE.—Except as provided in
23 subparagraph (B) —

24 “(i) a consent described in paragraph

1 (2) (A) shall be a consent with respect to all
2 patronage of the distributee with the organiza-
3 tion occurring (determined with the application
4 of section 1382 (e)) during the taxable year of
5 the organization during which such consent is
6 made and all subsequent taxable years of the
7 organization; and

8 “(ii) a consent described in paragraph
9 (2) (B) shall be a consent with respect to all
10 patronage of the distributee with the organiza-
11 tion occurring (determined without the applica-
12 tion of section 1382 (e)) after he received the
13 notification and copy described in paragraph
14 (2) (B) (ii) .

15 “(B) REVOCATION, ETC.—

16 “(i) Any consent described in paragraph
17 (2) (A) may be revoked (in writing) by the
18 distributee at any time. Any such revocation
19 shall be effective with respect to patronage
20 occurring on or after the first day of the first
21 taxable year of the organization beginning after
22 the revocation is filed with such organization;
23 except that in the case of a pooling arrangement
24 described in section 1382 (e) , a revocation made
25 by a distributee shall not be effective as to any

pool with respect to which the distributee has been a patron before such revocation.

“(ii) Any consent described in paragraph (2) (B) shall not be effective with respect to any patronage occurring (determined without the application of section 1382 (e)) after the distributee ceases to be a member of the organization or after the bylaws of the organization cease to contain the provision described in paragraph (2) (B) (i) .

“(d) NONQUALIFIED WRITTEN NOTICE OF ALLOCATION.—For purposes of this subchapter, the term ‘nonqualified written notice of allocation’ means a written notice of allocation which is not described in subsection (c) .

“(e) DETERMINATION OF AMOUNT PAID OR RECEIVED.—For purposes of this subchapter, in determining amounts paid or received—

“(1) property (other than a written notice of allocation) shall be taken into account at its fair market value, and

“(2) a qualified written notice of allocation shall be taken into account at its stated dollar amount.”

(b) TECHNICAL AMENDMENTS.—

(1) Section 521 (a) (relating to exemption of farm-

1 ers' cooperatives from tax) is amended by striking out
 2 "section 522" each place it appears therein and inserting
 3 in lieu thereof "part I of subchapter T (sec. 1381 and
 4 following)".

5 (2) Section 522 (relating to tax on farmers' coop-
 6 eratives) is hereby repealed.

7 (3) Section 6044 (relating to returns regarding
 8 patronage dividends) is amended to read as follows:

9 **"SEC. 6044. RETURNS REGARDING PATRONAGE DIVI-**
 10 **DENDS.**

11 "Any organization to which part I of subchapter T of
 12 chapter 1 (relating to tax treatment of cooperatives) ap-
 13 plies which pays amounts described in section 1382 (b), or
 14 (in the case of an organization described in section 1381
 15 (a) (1)) amounts described in section 1382 (c) (2), shall,
 16 when required by regulations of the Secretary or his delegate,
 17 make a return showing—

18 "(1) the name and address of each patron to whom
 19 it has made such payments during the calendar year; and

20 "(2) the amount of such payments to each patron."

21 (4) Section 6072 (d) (relating to time for filing
 22 income tax returns of exempt cooperative associations)
 23 is amended to read as follows:

24 "(d) RETURNS OF COOPERATIVE ASSOCIATIONS.—In
 25 the case of an income tax return of—

1 “(1) an exempt cooperative association described
2 in section 1381 (a) (1), or

3 “(2) an organization described in section 1381
4 (a) (2) which is under an obligation to pay patronage
5 dividends (as defined in section 1388 (a)) in an
6 amount equal to at least 50 percent of its net earnings
7 from business done with or for its patrons, or which
8 paid patronage dividends in such an amount out of the
9 net earnings from business done with or for patrons dur-
10 ing the most recent taxable year for which it had such
11 net earnings,

12 a return made on the basis of a calendar year shall be filed
13 on or before the 15th day of September following the close
14 of the calendar year, and a return made on the basis of a
15 fiscal year shall be filed on or before the 15th day of the 9th
16 month following the close of the fiscal year.”

17 (5) The table of subchapters for chapter 1 is
18 amended by adding at the end thereof the following:

 “SUBCHAPTER T. Cooperatives and their patrons.”

19 (6) The table of sections for part III of subchapter
20 F of chapter 1 is amended by striking out the last line
21 thereof.

22 (c) EFFECTIVE DATES.—

23 (1) FOR THE COOPERATIVES.—Except as provided

1 in paragraph (3), the amendments made by subsections
2 (a) and (b) shall apply to taxable years of organiza-
3 tions described in section 1381 (a) of the Internal Reve-
4 nue Code of 1954 (as added by subsection (a)) begin-
5 ning after December 31, 1962.

6 (2) FOR THE PATRONS.—Except as provided in
7 paragraph (3), section 1385 of the Internal Revenue
8 Code of 1954 (as added by subsection (a)) shall
9 apply with respect to any amount received from any
10 organization described in section 1381 (a) of such Code,
11 to the extent that such amount is paid by such organiza-
12 tion in a taxable year of such organization beginning
13 after December 31, 1962.

14 (3) APPLICATION OF EXISTING LAW.—In the case
15 of any money, written notice of allocation, or other prop-
16 erty paid by any organization described in section
17 1381 (a) —

18 (A) before the first day of the first taxable
19 year of such organization beginning after December
20 31, 1962, or

21 (B) on or after such first day with respect to
22 patronage occurring before such first day,
23 the tax treatment of such money, written notice of allo-
24 cation, or other property (including the tax treatment of
25 gain or loss on the redemption, sale, or other disposition

of such written notice of allocation) by any person shall be made under the Internal Revenue Code of 1954 without regard to subchapter T of chapter 1 of such Code.

SEC. 18. INCLUSION OF FOREIGN REAL PROPERTY IN GROSS ESTATE.

(a) AMENDMENTS TO INCLUDE FOREIGN REAL PROPERTY.—

(1) Section 2031 (a) (relating to definition of gross estate) is amended by striking out “, except real property situated outside of the United States”.

(2) The following provisions of chapter 11 (imposing an estate tax) are amended by striking out “(except real property situated outside of the United States)”:

(A) section 2033 (relating to property in which the decedent had an interest),

(B) section 2034 (relating to dower or curtesy interests),

(C) section 2035 (a) (relating to transactions in contemplation of death),

(D) section 2036 (a) (relating to transfers with retained life estate),

(E) section 2037 (a) (relating to transfers taking effect at death),

(F) section 2038 (a) (relating to revocable transfers),

1 (G) section 2040 (relating to joint interests),
2 and

3 (H) section 2041 (a) (relating to powers of
4 appointment).

5 (b) EFFECTIVE DATE.—

6 (1) Except as provided in paragraph (2), the
7 amendments made by subsection (a) shall apply to the
8 estates of decedents dying after the date of the enactment
9 of this Act.

10 (2) In the case of a decedent dying after the date
11 of the enactment of this Act and before July 1, 1964,
12 the value of real property situated outside of the United
13 States shall not be included in the gross estate (as defined
14 in section 2031 (a)) of the decedent—

15 (A) under section 2033, 2034, 2035 (a),
16 2036 (a), 2037 (a), or 2038 (a) to the extent the
17 real property, or the decedent's interest in it, was
18 acquired by the decedent before February 1, 1962;

19 (B) under section 2040 to the extent such
20 property or interest was acquired by the decedent
21 before February 1, 1962, or was held by the de-
22 cent and the survivor in a joint tenancy or tenancy
23 by the entirety before February 1, 1962; or

24 (C) under section 2041 (a) to the extent that
25 before February 1, 1962, such property or interest

1 was subject to a general power of appointment (as
2 defined in section 2041) possessed by the decedent.
3 In the case of real property, or an interest therein, sit-
4 uated outside of the United States (including a general
5 power of appointment in respect of such property or
6 interest, and including property held by the decedent
7 and the survivor in a joint tenancy or tenancy by the
8 entirety) which was acquired by the decedent after
9 January 31, 1962, by gift within the meaning of sec-
10 tion 2511, or from a prior decedent by devise or inheri-
11 tance, or by reason of death, form of ownership, or other
12 conditions (including the exercise or nonexercise of a
13 power of appointment), for purposes of this paragraph
14 such property or interest therein shall be deemed to have
15 been acquired by the decedent before February 1, 1962,
16 if before that date the donor or prior decedent had
17 acquired the property or his interest therein or had
18 possessed a power of appointment in respect of the prop-
19 erty or interest.

20 **SEC. 19. WITHHOLDING OF INCOME TAX AT SOURCE ON**
21 **INTEREST, DIVIDENDS, AND PATRONAGE DIVI-**
22 **DENDS.**

23 (a) **IN GENERAL.—**

24 (1) **AMENDMENT OF SUBTITLE C.—**Subtitle C (re-
25 lating to employment taxes and collection of income tax

1 at source) is amended by redesignating chapter 25 as
 2 chapter 26 and by inserting after chapter 24 the follow-
 3 ing new chapter:

4 **“CHAPTER 25—COLLECTION OF INCOME TAX**
 5 **AT SOURCE ON INTEREST, DIVIDENDS,**
 6 **AND PATRONAGE DIVIDENDS**

“SUBCHAPTER A. Interest.

“SUBCHAPTER B. Dividends.

“SUBCHAPTER C. Patronage dividends.

“SUBCHAPTER D. General provisions.

7 **“Subchapter A—Interest**

“Sec. 3451. Income tax collected at source on interest.

“Sec. 3452. Interest defined.

8 **“SEC. 3451. INCOME TAX COLLECTED AT SOURCE ON**
 9 **INTEREST.**

10 “(a) REQUIREMENT OF WITHHOLDING.—Except as
 11 otherwise provided in this chapter, every person who pays
 12 interest shall deduct and withhold on such interest a tax
 13 equal to 20 percent of the amount thereof.

14 “(b) PAYEE UNKNOWN.—If the withholding agent is
 15 unable to determine the person to whom the interest is pay-
 16 able, the tax under this section shall be deducted and with-
 17 held at the time payment of the interest would be made if
 18 such person were known.

1 “(c) CROSS REFERENCES.—

 “(1) For credit, against income tax of the recipient of the income, of amounts deducted and withheld under this section, see section 39.

 “(2) For special rules as to credit or refund of such amounts, see sections 3484, 3485, 3486, 3487, and 3505.

 “(3) For exemption from requirement of deducting and withholding on certain interest paid to certain persons, see section 3483.

2 “SEC. 3452. INTEREST DEFINED.

3 “(a) GENERAL RULE.—For purposes of this chapter,
4 the term ‘interest’ means—

5 “(1) interest on evidences of indebtedness (includ-
6 ing bonds, debentures, notes, and certificates) issued by
7 a corporation with interest coupons or in registered
8 form, and, to the extent provided in regulations pre-
9 scribed by the Secretary or his delegate, interest on
10 other evidences of indebtedness issued by a corporation
11 of a type offered by corporations to the public;

12 “(2) interest on deposits with persons carrying on
13 the banking business;

14 “(3) amounts (whether or not designated as in-
15 terest) paid by a mutual savings bank, savings and loan
16 association, building and loan association, cooperative
17 bank, homestead association, credit union, or similar

1 organization, in respect of deposits, investment certifi-
2 cates, or withdrawable or repurchasable shares;

3 “(4) interest on amounts held by an insurance com-
4 pany under an agreement to pay interest thereon;

5 “(5) interest on deposits with stockbrokers;

6 “(6) interest on obligations of the United States;

7 and

8 “(7) in the case of a non-interest-bearing obliga-
9 tion of the United States—

10 “(A) issued on a discount basis, and

11 “(B) having a maturity date more than one
12 year from the date of issue,

13 the amount by which the amount paid on surrender or
14 redemption exceeds the issue price.

15 “(b) EXCEPTIONS.—For purposes of this chapter, the
16 term ‘interest’ does not include—

17 “(1) interest on obligations described in section
18 103 (a) (1) or (3) (relating to interest on certain
19 governmental obligations) ;

20 “(2) any amount paid by—

21 “(A) a foreign government or international
22 organization,

23 “(B) a foreign corporation not engaged in
24 trade or business within the United States,

25 “(C) a nonresident alien individual not en-

1 gaged in trade or business within the United States,
2 or

3 “(D) a partnership not engaged in trade or
4 business within the United States and composed in
5 whole or in part of nonresident aliens;

6 “(3) interest on deposits with persons carrying on
7 the banking business paid to a person described in para-
8 graph (2) (B), (C), or (D) ;

9 “(4) any amount paid by one corporation to an-
10 other corporation, if both corporations are members of
11 the same affiliated group which filed a consolidated re-
12 turn for the preceding taxable year of the affiliated
13 group ;

14 “(5) interest subject to withholding under subchap-
15 ter A of chapter 3 (sec. 1441 and following, relating to
16 withholding of tax on nonresident aliens and foreign cor-
17 porations) by the person paying such interest, or which
18 would be so subject to withholding by such person, but
19 for the fact that it is not treated as income from sources
20 within the United States ;

21 “(6) any amount on which the withholding agent
22 is required to deduct and withhold a tax under section
23 1451 (relating to tax-free covenant bonds) , or would be
24 so required but for section 1451 (d) (relating to benefit
25 of personal exemptions) ;

1 “(7) to the extent provided in regulations pre-
 2 scribed by the Secretary or his delegate, any amount
 3 payable with respect to deposits in school savings
 4 accounts; and

5 “(8) any amount described in subsection (a) (2),
 6 (3), or (7) paid to a State or a foreign government
 7 or international organization (other than any amount
 8 described in subsection (a) (3) paid in respect of a
 9 transferable certificate or share).

10 “(c) EXEMPTION FOR UNITED STATES.—The Secre-
 11 tary may authorize exemption from the tax imposed by sec-
 12 tion 3451 for any amount paid by the United States or
 13 any wholly owned agency or instrumentality thereof to the
 14 United States or any wholly owned agency or instrumental-
 15 ity thereof if the Secretary determines that the imposition
 16 of the tax with respect to such amount will cause a burden
 17 or expense which can be avoided by granting the tax
 18 exemption.

19 **“Subchapter B—Dividends**

“Sec. 3461. Income tax collected at source on dividends.

“Sec. 3462. Dividend defined.

20 **“SEC. 3461. INCOME TAX COLLECTED AT SOURCE ON** 21 **DIVIDENDS.**

22 “(a) REQUIREMENT OF WITHHOLDING.—Except as
 23 otherwise provided in this chapter, every person who pays

1 a dividend shall deduct and withhold on such dividend a tax
2 equal to 20 percent of the amount thereof.

3 “(b) PAYEE UNKNOWN.—If the withholding agent is
4 unable to determine the person to whom the dividend is
5 payable, the tax under this section shall be deducted and
6 withheld at the time payment of the dividend would be
7 made if such person were known.

8 “(c) AMOUNT OF DIVIDEND UNKNOWN.—If the with-
9 holding agent is unable to determine the portion of a dis-
10 tribution which is a dividend, the tax under this section
11 shall be computed on the entire amount of the distribution.

12 “(d) CROSS REFERENCES.—

“ (1) For credit, against income tax of the recipient of
the income, of amounts deducted and withheld under this
section, see section 39.

“ (2) For special rules as to credit or refund of such
amounts, see sections 3484, 3485, 3486, 3487, and 3505.

“ (3) For exemption from requirement of deducting
and withholding on dividends paid to certain individuals,
see section 3483.

13 “SEC. 3462. DIVIDEND DEFINED.

14 “(a) GENERAL RULE.—For purposes of this chapter,
15 the term ‘dividend’ means—

16 “(1) any distribution by a corporation which is a
17 dividend (as defined in section 316) ; and

18 “(2) any payment made by a stockbroker to any
19 person as a substitute for a dividend (as so defined).

20 “(b) EXCEPTIONS.—For purposes of this chapter, the
21 term ‘dividend’ does not include—

1 “(1) any amount paid in the stock, or rights to
2 acquire the stock, of the distributing corporation if the
3 distribution is not includible in gross income of the re-
4 cipient under the provisions of section 305 (relating to
5 distributions of stock and stock rights) ;

6 “(2) any distribution to the extent that, under
7 chapter 1—

8 “(A) the amount thereof is treated by the re-
9 cipient as an amount received on the sale or ex-
10 change of property, or

11 “(B) gain or loss to the recipient is not recog-
12 nized;

13 “(3) any amount which is includible in gross in-
14 come as a taxable dividend by reason of the provisions
15 of section 302 (relating to redemptions of stock), 306
16 (relating to dispositions of certain stock), 356 (relating
17 to receipt of additional consideration in connection with
18 certain reorganizations), or 1081 (e) (2) (relating to
19 certain distributions pursuant to order of the Securities
20 and Exchange Commission) ;

21 “(4) any amount paid by one corporation to an-
22 other corporation, if both corporations are members of
23 the same affiliated group which filed a consolidated re-
24 turn for the preceding taxable year of the affiliated
25 group;

1 “(5) an amount which—

2 “(A) is subject to withholding under subchap-
3 ter A of chapter 3 (sec. 1441 and following, relating
4 to withholding of tax on nonresident aliens and for-
5 eign corporations) by the person paying such
6 amount, or

7 “(B) would be subject to withholding under
8 such subchapter A by the person paying such
9 amount but for—

10 “(i) the fact that it is attributable to in-
11 come from sources outside the United States, or

12 “(ii) the fact that the payor thereof is
13 excepted from the application of section
14 1441 (a) by the provisions of section 1441 (c) ;

15 “(6) any amount paid by a foreign corporation not
16 engaged in trade or business within the United States;

17 “(7) any amount described in section 1373 (relat-
18 ing to undistributed taxable income of electing small
19 business corporations) ; and

20 “(8) amounts paid pursuant to the terms of a
21 lease entered into before January 1, 1954, if under such
22 lease the shareholders of the lessor corporation are en-
23 titled to such amounts without deduction for any tax
24 which any law of the United States might require to be
25 deducted and withheld on the payment of dividends.

1 **“Subchapter C—Patronage Dividends**

“Sec. 3471. Income tax collected at source on patronage dividends.

“Sec. 3472. Amounts subject to withholding.

2 **“SEC. 3471. INCOME TAX COLLECTED AT SOURCE ON** 3 **PATRONAGE DIVIDENDS.**

4 “(a) REQUIREMENT OF WITHHOLDING.—Except as
5 otherwise provided in this chapter, every cooperative to
6 which part I of subchapter T of chapter 1 applies which pays
7 an amount described in section 3472 shall deduct and with-
8 hold on such amount a tax equal to 20 percent of such
9 amount.

10 “(b) PAYEE UNKNOWN.—If the withholding agent is
11 unable to determine the person to whom the amount is pay-
12 able, the tax under this section shall be deducted and with-
13 held at the time payment of the amount would be made if
14 such person were known.

15 “(c) CROSS REFERENCES.—

“ (1) For credit, against income tax of the recipient of the income, of amounts deducted and withheld under this section, see section 39.

“ (2) For special rules as to credit or refund of such amounts, see sections 3484, 3485, 3486, 3487, and 3505.

“ (3) For exemption from requirement of deducting and withholding on amounts paid to certain individuals, see section 3483.

16 **“SEC. 3472. AMOUNTS SUBJECT TO WITHHOLDING.**

17 “(a) GENERAL RULE.—Except as otherwise provided
18 in this section or section 3483, the amounts subject to deduc-
19 tion and withholding under section 3471 are—

1 “(1) the amount of any patronage dividend (as
2 defined in section 1388 (a)) which is paid in money,
3 qualified written notices of allocation (as defined in sec-
4 tion 1388 (c)), or other property (except nonqualified
5 written notices of allocation as defined in section
6 1388 (d)), and

7 “(2) any amount, described in section 1382 (c) (2)
8 (A) (relating to certain nonpatronage distributions),
9 which is paid in money, qualified written notices of al-
10 location, or other property (except nonqualified written
11 notices of allocation) by an organization exempt from
12 tax under section 521 (relating to exemption of farm-
13 ers’ cooperatives from tax).

14 “(b) EXCEPTIONS.—The provisions of section 3471
15 shall not apply to—

16 “(1) any amount paid by one corporation to an-
17 other corporation, if both corporations are members of
18 the same affiliated group which filed a consolidated re-
19 turn for the preceding taxable year of the affiliated
20 group;

21 “(2) an amount which—

22 “(A) is subject to withholding under sub-
23 chapter A of chapter 3 (sec. 1441 and following,
24 relating to withholding of tax on nonresident aliens

1 and foreign corporations) by the person paying such
2 amount, or

3 “(B) would be subject to withholding under
4 such subchapter A by the person paying such
5 amount but for the fact that it is attributable to
6 income from sources outside the United States; and

7 “(3) any amount paid by a foreign corporation
8 not engaged in trade or business within the United
9 States.

10 “(c) EXEMPTION FOR CERTAIN CONSUMER COOPERA-
11 TIVES.—A cooperative which the Secretary or his delegate
12 determines is primarily engaged in selling at retail goods
13 or services of a type that are generally for personal, living,
14 or family use shall, upon application to the Secretary or his
15 delegate, be granted exemption from the tax imposed by
16 section 3471. Application for exemption under this sub-
17 section shall be made in accordance with regulations pre-
18 scribed by the Secretary or his delegate.

19 “(d) DETERMINATION OF AMOUNT PAID.—For pur-
20 poses of this subchapter, in determining amounts paid—

21 “(1) property (other than a written notice of
22 allocation) shall be taken into account at its fair market
23 value, and

24 “(2) a qualified written notice of allocation shall
25 be taken into account at its stated dollar amount.

1 **“Subchapter D—General Provisions**

“Sec. 3481. Liability for return and payment of withheld tax.

“Sec. 3482. Return and payment by United States.

“Sec. 3483. Exemption certificates.

“Sec. 3484. Refund of tax to individuals.

“Sec. 3485. Refund of tax to States, tax-exempt organizations, etc.

“Sec. 3486. Refund of tax to corporation.

“Sec. 3487. Credit for tax withheld on corporation.

“Sec. 3488. Obligation sold between interest-payment dates.

“Sec. 3489. Presumption.

“Sec. 3490. Definitions.

2 **“SEC. 3481. LIABILITY FOR RETURN AND PAYMENT OF** 3 **WITHHELD TAX.**

4 “(a) **GENERAL RULE.**—Every person required to de-
5 duct and withhold any tax under this chapter shall, on or be-
6 fore the last day of the first month following the close of each
7 quarter of his taxable year, make a return of the tax required
8 to be deducted and withheld during such quarter and pay the
9 tax to the officer designated in section 6151. The withhold-
10 ing agent shall be liable for the payment of the taxes required
11 to be deducted and withheld under this chapter, and shall not
12 otherwise be liable to any person for the amount of any
13 such payment.

14 “(b) **TAX PAID BY RECIPIENT.**—If the withholding
15 agent, in violation of the provisions of this chapter, fails to
16 deduct and withhold any tax under this chapter, and there-
17 after the tax against which such tax may be credited is
18 paid, the tax so required to be deducted and withheld shall

1 not be collected from the withholding agent; but this sub-
2 section shall in no case relieve the withholding agent from
3 liability for any penalties or additions to the tax otherwise
4 applicable in respect of such failure to deduct and withhold.

5 “(c) CROSS REFERENCE.—

“For limitation on the use of Government depositaries
in the collection of taxes deducted and withheld under
this chapter, see the last sentence of section 6302(c).

6 **“SEC. 3482. RETURN AND PAYMENT BY UNITED STATES.**

7 “If the withholding agent is the United States the re-
8 turn of the tax deducted and withheld under this chapter may
9 be made by an officer or employee of the United States
10 having control of the payment of the amount subject to
11 withholding, or appropriately designated for that purpose.

12 **“SEC. 3483. EXEMPTION CERTIFICATES.**

13 “(a) GENERAL RULES.—

14 “(1) INDIVIDUALS UNDER AGE 18.—Any indi-
15 vidual may file with any withholding agent an exemp-
16 tion certificate on which he certifies the date of his
17 birth. If such a certificate is filed, all amounts pay-
18 able by such withholding agent to such individual, on
19 and after the effective date for such certificate and
20 before the beginning of the calendar year during which
21 the certificate indicates that he will attain age 18, shall
22 be exempt from the requirement of deducting and with-
23 holding under this chapter.

1 “(2) INDIVIDUALS OVER AGE 17.—Any individual
2 may file with any withholding agent an exemption
3 certificate on which he certifies—

4 “(A) that he will have attained age 18 before
5 the close of the calendar year for which such certifi-
6 cate is filed, and

7 “(B) that he reasonably believes that he will
8 not (after the application of the credits against tax
9 provided by part IV of subchapter A of chapter 1,
10 other than the credits under sections 31 and 39) be
11 liable for the payment of any tax under chapter 1 for
12 each of his taxable years any portion of which is
13 included in the period for which such certificate
14 will be in effect.

15 If such a certificate is filed, all amounts payable by such
16 withholding agent to such individual during the period
17 such certificate is in effect shall be exempt from the
18 requirement of deducting and withholding under this
19 chapter. Except as may otherwise be provided in regu-
20 lations prescribed by the Secretary or his delegate, an
21 exemption certificate filed by an individual described in
22 this paragraph shall remain in effect only for the period
23 beginning on the effective date of such certificate and

1 ending at the close of the calendar year in which such
2 period begins.

3 “(3) TAX-EXEMPT ORGANIZATIONS.—

4 “(A) Any organization (other than a coopera-
5 tive described in section 521) which is exempt from
6 the tax imposed by chapter 1 may file with any
7 withholding agent who pays amounts described in
8 section 3452 (a) (2), (3), or (7) an exemption
9 certificate on which it certifies that it is such an
10 organization. If such a certificate is filed, all
11 amounts described in section 3452 (a) (2),
12 (3), and (7) payable by such withholding agent
13 to such organization on and after the effective date
14 for such certificate shall (except as provided in sub-
15 paragraph (B)) be exempt from the requirement
16 of deducting and withholding under this chapter.

17 “(B) An exemption certificate filed by an
18 organization under subparagraph (A) shall cease
19 to be effective on the thirtieth day after the day on
20 which the withholding agent, with whom such cer-
21 tificate was filed, is notified by either the organiza-
22 tion or the Secretary or his delegate that the
23 organization is no longer exempt from the tax im-
24 posed by chapter 1. If an organization ceases to be
25 exempt from such tax, it shall, within the time speci-

1 fied in regulations prescribed by the Secretary or his
2 delegate, so notify each withholding agent with
3 whom it has an exemption certificate in effect.

4 “(b) EXCEPTIONS AND SPECIAL RULES.—

5 “(1) CERTAIN EXCEPTIONS.—This section shall
6 not apply to any amount—

7 “(A) described in section 3452 (a) (1) (re-
8 lating to interest on evidences of indebtedness),

9 “(B) described in section 3452 (a) (3) paid
10 in respect of a transferable certificate or share, or

11 “(C) described in section 3452 (a) (6) (relat-
12 ing to interest on obligations of the United States).

13 “(2) SERIES E BONDS, ETC.—In the case of trans-
14 actions involving the redemption of one or more obliga-
15 tions described in section 3452 (a) (7) (relating to cer-
16 tain obligations of the United States issued on a discount
17 basis), a separate certificate shall be filed with respect
18 to each such transaction.

19 “(3) NOMINEES, CUSTODIANS, AND JOINT OWNER-
20 SHIPS.—Under regulations prescribed by the Secretary
21 or his delegate, the exemption provided by subsection
22 (a) may be extended, in a manner consistent with the
23 other provisions of this section, to—

24 “(A) amounts (other than amounts described

1 in section 3462 (a), relating to dividends) paid
2 through nominees;

3 “(B) amounts paid to custodians; and

4 “(C) amounts paid jointly to 2 or more
5 individuals.

6 “(4) EFFECTIVE DATE OF CERTIFICATE.—Any
7 exemption certificate under this section shall take effect
8 on such day as is specified in accordance with regula-
9 tions prescribed by the Secretary or his delegate.

10 “(5) FORM AND CONTENTS OF CERTIFICATE AND
11 NOTICE.—Any exemption certificate under this section,
12 and any notice under subsection (a) (3) (B), shall be
13 in such form and contain such information as the Secre-
14 tary or his delegate may by regulations prescribe.

15 “(c) CROSS REFERENCE.—

“For penalty for filing fraudulent certificate, or for
failing to provide notice, under this section, see section
7205.

16 “SEC. 3484. REFUND OF TAX TO INDIVIDUALS.

17 “(a) GENERAL RULE.—Except as provided in subsec-
18 tion (e), the tax deducted and withheld under this chapter
19 with respect to amounts received by an individual during
20 any quarter (other than the fourth quarter) of his taxable
21 year (together with any tax so deducted and withheld on
22 amounts which were received by him during any prior quar-
23 ter of such year and with respect to which no allowable claim

1 for refund has been filed under this section) shall, to the
2 extent such tax does not exceed his refund allowance as of
3 the time the claim for refund is filed, be promptly refunded
4 to him as an overpayment of tax. A refund of tax shall be
5 made under this section only if the amount claimed and
6 allowable equals or exceeds \$10.

7 “(b) REFUND ALLOWANCE.—For purposes of this sec-
8 tion, the refund allowance of an individual as of the time the
9 claim for refund is filed is an amount equal to the excess, if
10 any, of—

11 “(1) an amount equal to 22 percent of—

12 “(A) the total of the deductions which, on the
13 basis of facts existing at the time the claim for refund
14 is filed, such individual would be allowed for the tax-
15 able year under section 151 (relating to deductions
16 for personal exemptions), plus

17 “(B) in the case of an individual who, at the
18 time the claim for refund is filed, reasonably ex-
19 pects that he will be allowed a credit under section
20 37 (relating to retirement income) for the taxable
21 year, the amount which, at such time, such individ-
22 ual reasonably expects to be the amount of his
23 retirement income (as defined in section 37 (c) and
24 as limited by section 37 (d)) for the taxable year,
25 less

1 “(C) the amounts (other than amounts on
2 which tax is required to be deducted and withheld
3 under this chapter) which, at the time the claim for
4 refund is filed, such individual reasonably expects
5 to be includible in his gross income for the taxable
6 year; over

7 “(2) the amounts of tax with respect to which an
8 allowable claim for refund has been previously filed
9 under this section during the taxable year.

10 For purposes of paragraph (1) (C), an individual who
11 files more than one claim for refund under this section for
12 any taxable year may use the estimate for the preceding
13 claim for such year unless, at the time he files the claim,
14 he reasonably expects the amounts referred to in paragraph
15 (1) (C) to exceed such prior estimate by more than \$100.

16 “(c) MARRIED INDIVIDUALS.—For purposes of subsec-
17 tions (a), (b), and (d), married individuals shall be treated
18 as an individual if, at the time the claim for refund is filed,
19 they reasonably expect that they will file a joint return for
20 the taxable year in which such claim is filed.

21 “(d) TIME FOR FILING CLAIM.—Not more than one
22 claim may be filed under this section by any individual
23 during any quarter of his taxable year. A refund of tax
24 deducted and withheld on amounts received during a taxable

1 year shall be made under this section only if claim therefor
2 is filed on or before the last day of such taxable year.

3 “(e) INDIVIDUALS NOT ELIGIBLE FOR REFUND.—No
4 claim for refund may be filed under this section by—

5 “(1) any individual (other than an individual
6 referred to in paragraph (2) or (3)) unless, at the
7 time the claim for refund is filed, he reasonably expects
8 that his gross income for the taxable year will not ex-
9 ceed \$5,000;

10 “(2) any married individual unless, at the time the
11 claim for refund is filed, he reasonably expects that the
12 aggregate gross income of such individual and his spouse
13 for the taxable year will not exceed \$10,000;

14 “(3) a head of a household (as defined in section
15 1 (b) (2)) or a surviving spouse (as defined in section
16 2 (b)) unless, at the time the claim for refund is filed,
17 he reasonably expects that his gross income for the
18 taxable year will not exceed \$10,000; or

19 “(4) any child, unless, at the time the claim for
20 refund is filed, he reasonably expects that no deduction
21 would be allowed for him under section 151 (e) (1) (B)
22 for the taxable year of his parent (or parents) begin-
23 ning with or within the calendar year in which the
24 claim for refund is filed.

1 “(f) CROSS REFERENCE.—

 “For credit or refund of amounts not refunded under
this section, see section 39.

2 “SEC. 3485. REFUND OF TAX TO STATES, TAX-EXEMPT
3 ORGANIZATIONS, ETC.

4 “(a) GENERAL RULE.—In the case of a person which
5 is—

6 “(1) the United States or a State,

7 “(2) an organization (other than a cooperative
8 described in section 521) which is exempt from the tax
9 imposed by chapter 1,

10 “(3) a foreign government or international organi-
11 zation, or

12 “(4) a foreign central bank of issue,

13 if the tax deducted and withheld under this chapter with re-
14 spect to amounts received by such person during any calendar
15 quarter exceeds the credit, if any, claimed by and allowable
16 to such person under section 3505 (relating to credit against
17 employment taxes) for such quarter, the excess (together
18 with any such excess for any prior quarter of the same
19 calendar year with respect to which no refund has been
20 claimed and allowed under this section) shall be promptly
21 refunded or credited to such person as an overpayment of
22 tax. In the case of a person to which paragraph (4) ap-
23 plies, the amount which may be refunded or credited under

1 this section shall not exceed the amount of tax deducted
2 and withheld under section 3451 on interest paid on obliga-
3 tions of the United States which are not held for, or used in
4 connection with, the conduct of commercial banking functions
5 or other commercial activities.

6 “(b) CROSS REFERENCES.—

“(1) For period of limitation for filing claim under this section, see section 6511.

“(2) For presumed date of payment for purposes of (A) period of limitation, see section 6513(b), and (B) allowance of interest on overpayments, see section 6611(d).

7 **“SEC. 3486. REFUND OF TAX TO CORPORATION.**

8 “(a) GENERAL RULE.—If the tax deducted and with-
9 held under this chapter with respect to amounts received by
10 a corporation (other than a corporation described in section
11 3485 (a)) during any quarter (other than the fourth quar-
12 ter) of its taxable year exceeds the amount claimed by and
13 allowable to such corporation under section 3487 as a credit
14 against its liability for tax under this chapter for such quar-
15 ter, the excess (together with any such excess for any prior
16 quarter of the same year with respect to which no refund has
17 been claimed and allowed under this section) shall be
18 promptly refunded or credited to such corporation as an over-
19 payment of tax. A refund of tax shall be made under this
20 section only if claim therefor is filed after the close of the
21 period covered by the claim and on or before the last day
22 of the taxable year.

1 “(b) CROSS REFERENCE.—

 “For credit or refund of amounts not refunded under
this section, see section 39.

2 “SEC. 3487. CREDIT FOR TAX WITHHELD ON CORPO-
3 RATION.

4 “(a) GENERAL RULE.—Any tax deducted and with-
5 held under this chapter with respect to amounts received
6 by a corporation (other than a corporation described in sec-
7 tion 3485 (a)) during a taxable year shall, to the extent not
8 claimed and allowable as a credit or refund to the corporation
9 under section 3486, be allowed, under regulations prescribed
10 by the Secretary or his delegate, as a credit against (but
11 not in excess of) the tax for which such corporation is liable
12 under this chapter in respect of amounts paid by it during
13 such year.

14 “(b) DIVIDENDS AND PATRONAGE DIVIDENDS PAID
15 DURING TAXABLE YEAR.—For purposes of determining the
16 credit allowable to any corporation under subsection (a) , a
17 dividend, or amount subject to withholding under section
18 3471, paid by it may be considered as having been paid
19 during the taxable year—

20 “(1) in the case of a personal holding company, if
21 treated as paid during such taxable year under section
22 563 (b) ,

23 “(2) in the case of a regulated investment com-

pany, if treated as paid during such taxable year under section 855 (a) ,

“(3) in the case of a real estate investment trust, if treated as paid during such taxable year under section 858 (a) , or

“(4) in the case of a cooperative described in section 1381 (a) , if paid during the payment period (as defined in section 1382 (d)) for such taxable year.

“(c) SPECIAL RULE FOR CORPORATIONS WHICH ARE MEMBERS OF AN AFFILIATED GROUP.—To the extent and subject to such conditions as may be provided in regulations prescribed by the Secretary or his delegate, the tax deducted and withheld under this chapter with respect to amounts received by a corporation which is a member of an affiliated group which filed a consolidated return for the preceding taxable year of the affiliated group may, for purposes of this section, be treated as tax deducted and withheld under this chapter from any corporation which is a member of the same affiliated group.

“SEC. 3488. OBLIGATION SOLD BETWEEN INTEREST-PAYMENT DATES.

“For purposes of any credit or refund provided in section 3484, 3485, 3486, or 3487, in the case of an obligation which is sold or exchanged between interest-payment dates the amount required to be deducted and withheld on

1 the interest at the end of the interest-payment period shall
2 be treated in the manner provided in section 39(c).

3 **“SEC. 3489. PRESUMPTION.**

4 “For purposes of establishing that any person is entitled
5 to a credit or refund of any tax required to be deducted and
6 withheld under this chapter with respect to amounts received
7 by such person, the correct amount of such tax shall, in the
8 absence of evidence to the contrary, be presumed to have
9 been so deducted and withheld.

10 **“SEC. 3490. DEFINITIONS.**

11 “For purposes of this chapter—

12 “(1) **PERSON.**—The term ‘person’ includes the
13 United States, a State, a foreign government, and an
14 international organization.

15 “(2) **STATE.**—The term ‘State’ includes a State, the
16 District of Columbia, a possession of the United States,
17 any political subdivision of any of the foregoing, and any
18 wholly owned agency or instrumentality of any one or
19 more of the foregoing.

20 “(3) **FOREIGN GOVERNMENT.**—The term ‘foreign
21 government’ includes a foreign government, a politi-
22 cal subdivision of a foreign government, and any wholly

owned agency or instrumentality of any one or more of the foregoing.

“(4) NONRESIDENT ALIEN.—The term ‘nonresident alien individual’ includes an alien resident of Puerto Rico.”

(2) CLERICAL AMENDMENTS, ETC.—

(A) The heading for subtitle C is amended to read as follows:

“Subtitle C—Employment Taxes and Collection of Income Tax at Source”

(B) The table of chapters for subtitle C is amended by striking out the last line and inserting in lieu thereof the following:

“CHAPTER 25. Collection of income tax at source on interest, dividends, and patronage dividends.

“CHAPTER 26. General provisions relating to employment taxes and collection of income taxes at source.”

(C) The table of subtitles under the heading “Internal Revenue Title” at the beginning of the Internal Revenue Code of 1954 is amended by striking out the third line and inserting in lieu thereof the following:

“SUBTITLE C. Employment taxes and collection of income tax at source.”

1 (D) The heading for chapter 26 (as redesign-
 2 nated by paragraph (1) of this subsection) is
 3 amended to read as follows:

4 **“CHAPTER 26—GENERAL PROVISIONS RE-**
 5 **LATING TO EMPLOYMENT TAXES AND**
 6 **COLLECTION OF INCOME TAXES AT**
 7 **SOURCE”**

8 (b) CREDITS AGAINST INCOME TAX FOR TAX WITH-
 9 HELD.—

10 (1) ALLOWANCE OF CREDIT.—Part IV of sub-
 11 chapter A of chapter 1 (relating to credits against tax)
 12 is amended by inserting after section 38 (added by
 13 section 2 of this Act) the following new section:

14 **“SEC. 39. TAX WITHHELD ON INTEREST, DIVIDENDS, AND**
 15 **PATRONAGE DIVIDENDS.**

16 “(a) GENERAL RULE.—Under regulations prescribed
 17 by the Secretary or his delegate, the tax deducted and with-
 18 held under chapter 25 (relating to withholding at source
 19 on interest, dividends, and patronage dividends) shall be
 20 allowed, to the recipient of the amount with respect to which
 21 such tax was deducted and withheld, as a credit against the
 22 tax imposed by this subtitle for the taxable year in which
 23 such amount is received.

24 “(b) SPECIAL RULE FOR DEPENDENT CHILDREN.—If—
 25 “(1) the taxpayer for his taxable year is entitled

1 to a deduction under section 151 (e) (1) (B) with re-
2 spect to a child, and

3 “(2) such child had, for the calendar year ending
4 with or within the taxpayer’s taxable year—

5 “(A) gross income of less than \$600, and

6 “(B) no wages (as defined in section 3401
7 (a)) with respect to which withholding was re-
8 quired under chapter 24,

9 then, under regulations prescribed by the Secretary or his
10 delegate, the taxpayer shall be entitled to the credit pro-
11 vided by subsection (a) with respect to amounts received
12 by such child during such calendar year, but only if such
13 child has not filed any claim for credit or refund of any por-
14 tion of the tax deducted and withheld with respect to such
15 amounts.

16 “(c) APPORTIONMENT OF CREDIT.—For purposes of
17 subsection (a) , if an obligation is sold or exchanged between
18 interest-payment dates—

19 “(1) so much of the amount required to be deducted
20 and withheld on the interest at the end of the interest-
21 payment period as is properly allocable to that part of
22 such period which ends on the date of the sale or ex-
23 change shall be treated as an amount deducted and with-
24 held from the transferor on the date of the sale or
25 exchange, and

1 “(2) so much of such amount as is properly al-
2 locable to that part of such period which begins on the
3 day after the date of the sale or exchange shall be treated
4 as an amount deducted and withheld from the transferee.

5 “(d) LIMITATIONS.—The credit provided by subsection
6 (a) shall not be allowed—

7 “(1) REFUND TO INDIVIDUALS.—To any indi-
8 vidual with respect to any amount of tax allowed him
9 as a refund under section 3484.

10 “(2) CREDIT OR REFUND TO STATES, ETC.—To
11 any person with respect to any amount of tax allowable
12 to such person as a credit or refund under section 3485
13 or as a credit under section 3505.

14 “(3) CREDIT OR REFUND TO CORPORATIONS.—To
15 any person with respect to any amount of tax allowed
16 such person as a credit or refund under section 3486 or
17 as a credit under section 3487.

18 “(4) CERTAIN DEPENDENT CHILDREN.—To any
19 person with respect to any amount of tax which has
20 been claimed and is allowable as a credit to such
21 person's parent by reason of the provisions of subsection
22 (b).

23 “(5) NOMINEES, ETC.—To any person with respect
24 to any amount of tax allowed such person as a credit
25 under section 1444 (b).”

1 (2) COMMON TRUST FUNDS.—Section 584 (c) (re-
2 lating to the income of participants in the fund) is
3 amended by adding at the end thereof the following
4 new paragraph:

5 “(3) TAX WITHHELD AT SOURCE ON INTEREST,
6 DIVIDENDS, AND PATRONAGE DIVIDENDS.—In any case
7 where tax under chapter 25 is deducted and withheld
8 on any amounts received by a common trust fund, for
9 purposes of any credit or refund provided in section 39
10 or 3505, or chapter 25, such tax shall, in accordance
11 with regulations prescribed by the Secretary or his dele-
12 gate, be considered as having been deducted and with-
13 held proportionately from each participant.”

14 (3) ESTATES AND TRUSTS.—Section 642 (a) (re-
15 lating to special rules for credits and deductions in the
16 case of estates and trusts) is amended by adding at the
17 end thereof the following new paragraph:

18 “(4) TAX WITHHELD AT SOURCE ON INTEREST,
19 DIVIDENDS, AND PATRONAGE DIVIDENDS.—In any case
20 where tax under chapter 25 is deducted and withheld
21 on any amounts received by an estate or trust, for pur-
22 poses of any credit or refund provided in section 39
23 or 3505, or chapter 25, such tax shall, in accordance
24 with regulations prescribed by the Secretary or his dele-
25 gate, be considered as having been deducted and with-

1 held from each beneficiary in an amount which, when
2 added to the amounts paid, credited, or required to be
3 distributed to him, equals the amounts which would
4 have been paid, credited, or required to be distributed
5 to him in the absence of chapter 25. Any tax under
6 chapter 25 which is deducted and withheld on amounts
7 received by the estate or trust shall be considered as
8 withheld from such estate or trust to the extent it is
9 not considered as withheld from a beneficiary under
10 the provisions of the preceding sentence.”

11 (4) TECHNICAL AMENDMENTS.—

12 (A) Section 164(b)(1) (relating to deduc-
13 tion denied in the case of certain taxes) is amended
14 by—

15 (i) striking out the word “and” at the end
16 of subparagraph (B) ;

17 (ii) striking out the comma at the end of
18 subparagraph (C) and inserting “; and”; and

19 (iii) adding after subparagraph (C) the
20 following new subparagraph:

21 “(D) the tax withheld at source under chapter

1 25 (relating to collection of income tax at source
2 on interest, dividends, and patronage dividends),”.

3 (B) Section 874 (a) (relating to allowance of
4 deductions and credits to nonresident alien indi-
5 viduals) is amended by striking “31 and 32” and
6 inserting in lieu thereof “31, 32, and 39”.

7 (C) Section 1314 (e) (relating to inapplica-
8 bility of part II of subchapter Q of chapter 1 of
9 subtitle A to taxes imposed by subtitle C) is
10 amended by striking “employment taxes” and in-
11 serting in lieu thereof “employment taxes and
12 collection of income tax at source”.

13 (D) Section 6211 (b) (1) (relating to rules
14 applicable in determination of deficiency) is
15 amended by striking “31” and inserting in lieu
16 thereof “31 or 39”.

17 (E) The table of sections for part IV of sub-
18 chapter A of chapter 1 is amended by striking out

“Sec. 38. Overpayments of tax.”

19 and inserting in lieu thereof

“Sec. 38. Investment in certain depreciable property.

“Sec. 39. Tax withheld on interest, dividends, and patronage
dividends.

“Sec. 40. Overpayments of tax.”

1 (c) INTEREST AND DIVIDENDS PAID TO NONRESIDENT
2 ALIENS, ETC.—

3 (1) WITHHOLDING RATE.—

4 (A) Section 1441 (relating to withholding of
5 tax on nonresident aliens) is amended by adding at
6 the end thereof the following new subsection:

7 “(e) TREATIES.—In the case of amounts described in
8 section 3452 (a) (relating to interest), section 3462 (a)
9 (relating to dividends), and section 3472 (a) (relating to
10 patronage dividends), the tax required to be deducted and
11 withheld under subsection (a) shall not by reason of the
12 provisions of any treaty be less than 20 percent of such
13 amounts.”

14 (B) Section 1442 (relating to withholding of
15 tax on foreign corporations) is amended by adding
16 at the end thereof the following new sentence: “In
17 the case of amounts described in section 3452 (a)
18 (relating to interest), section 3462 (a) (relating to
19 dividends), and section 3472 (a) (relating to pa-
20 tronage dividends), the tax required to be deducted
21 and withheld under the preceding sentence shall
22 not by reason of the provisions of any treaty be
23 less than 20 percent of such amounts.”

24 (2) NOMINEES, ETC.—Subchapter A of chapter
25 3 (relating to withholding of tax on nonresident aliens

and foreign corporations) is amended by adding at the end thereof the following new section:

“SEC. 1444. INTEREST AND DIVIDENDS PAID TO NOMINEES; CREDITS TO WITHHOLDING AGENTS.

“(a) **WITHHOLDING OF TAX BY PAYOR.**—Under regulations prescribed by the Secretary or his delegate, every person who pays amounts subject to withholding under chapter 25 and who has been notified by a payee thereof that the payee is a nominee required to deduct and withhold on such amounts under section 1441 or 1442 shall, in lieu of the nominee, deduct and withhold from such amounts paid to the nominee the tax required to be deducted and withheld under section 1441 or 1442, in the same manner as if such amounts were paid by such person directly to the beneficial owner thereof.

“(b) **CREDITS TO WITHHOLDING AGENTS.**—In the case of any person who is required to deduct and withhold tax under section 1441 or 1442 in respect of amounts received by him during any calendar year on which tax was deducted and withheld (or, in the case of amounts described in section 39(c)(1), was treated as deducted and withheld) under chapter 25, the taxes so deducted and withheld (or treated as deducted and withheld) under chapter 25 shall, under regulations prescribed by the Secretary or his delegate, be allowed as a credit against (but not in excess of) his liability

1 for the year in respect of the taxes imposed by sections 1441
2 and 1442.”

3 (3) CLERICAL AMENDMENT.—The table of sec-
4 tions for subchapter A of chapter 3 is amended by add-
5 ing at the end thereof the following:

“Sec. 1444. Interest and dividends paid to nominees; credits
to withholding agents.”

6 (d) CREDIT FOR STATES AND TAX-EXEMPT ORGANI-
7 ZATIONS.—

8 (1) ALLOWANCE OF CREDIT.—Chapter 26 (gen-
9 eral provisions relating to employment taxes and income
10 tax withheld at source) is amended by adding at the
11 end thereof the following new section:

12 “SEC. 3505. SPECIAL CREDIT IN CASE OF STATES OR TAX-
13 EXEMPT ORGANIZATIONS.

14 “(a) GENERAL RULE.—In the case of a person which is
15 a State (as defined in section 3490 (2)) or which is an or-
16 ganization (other than a cooperative described in section
17 521) which is exempt from the tax imposed by chapter
18 1, the tax deducted and withheld under chapter 25 with
19 respect to amounts received by it during any calendar
20 quarter shall be allowed, under regulations prescribed
21 by the Secretary or his delegate, as a credit against
22 (but not in excess of) such person’s liability (after the
23 adjustments, if any, provided for in sections 6205 (a)

1 and 6413(a)) for such quarter in respect of the taxes
 2 imposed by chapter 21 (Federal Insurance Contributions
 3 Act) and by chapter 24 (collection of income tax at source
 4 on wages). Such credit shall be allowed only if claim
 5 therefor is made, in accordance with such regulations, at the
 6 time of the filing of the return with respect to the taxes under
 7 chapter 21 and chapter 24 for such quarter.

8 “(b) OBLIGATIONS SOLD BETWEEN INTEREST-PAY-
 9 MENT DATES.—For purposes of this section, in the case of
 10 an obligation which is sold or exchanged between interest-
 11 payment dates, the amount required to be deducted and with-
 12 held on the interest at the end of the interest-payment period
 13 shall be treated in the manner provided in section 39(c).

14 “(c) CROSS REFERENCE.—

“For refund under chapter 25, see section 3485.”

15 (2) TECHNICAL AMENDMENTS.—

16 (A) Section 3502 (relating to nondeductibil-
 17 ity of taxes in computing taxable income) is
 18 amended by adding at the end thereof the following
 19 new subsection:

20 “(c) The tax deducted and withheld under chapter 25
 21 shall not be allowed as a deduction in computing taxable
 22 income under subtitle A either to the person deducting and
 23 withholding the tax or to the recipient of the amounts sub-
 24 ject to withholding.”

1 (B) The table of sections for chapter 26 is
2 amended by adding at the end thereof the following:

“Sec. 3505. Special credit in case of States or tax-exempt organizations.”

3 (e) OTHER TECHNICAL AMENDMENTS.—

4 (1) DECLARATION OF ESTIMATED INCOME TAX
5 BY INDIVIDUALS.—Section 6015 (a) (relating to dec-
6 laration of estimated income tax by individuals) is
7 amended by striking out the period at the end of para-
8 graph (2) and inserting in lieu thereof “and amounts on
9 which tax is required to be deducted and withheld under
10 chapter 25.”.

11 (2) ADJUSTMENT OF TAX; UNDERPAYMENT.—

(A) Subsection (a) (1) of section 6205 (relating to special rules relating to assessment of employment taxes) is amended by striking out “or 3402 is paid with respect to any payment of wages or compensation,” and inserting in lieu thereof “3402, 3451, 3461, or 3471 is paid with respect to any payment of remuneration, interest, dividends, or other amounts.”.

(B) Subsection (b) of such section is amended
by striking out “or 3402 is paid or deducted with re-
spect to any payment of wages or compensation”
and inserting in lieu thereof “3402, 3451, 3461, or

3471 is paid or deducted with respect to any payment of remuneration, interest, dividends, or other amounts”.

(C) The heading for such section is amended to read as follows:

“SEC. 6205. SPECIAL RULES APPLICABLE TO CERTAIN TAXES UNDER SUBTITLE C.”

(D) The table of sections for subchapter A of chapter 63 is amended by striking out

“Sec. 6205. Special rules applicable to certain employment taxes.”

and inserting in lieu thereof

“Sec. 6205. Special rules applicable to certain taxes under subtitle C.”

(3) **USE OF GOVERNMENT DEPOSITARIES.**—Section 6302 (c) (relating to use of Government depositaries) is amended by adding at the end thereof the following new sentence: “The Secretary or his delegate shall not require the deposit under this subsection of any tax deducted and withheld under chapter 25 (relating to collection of income tax at source on interest, dividends, and patronage dividends) in a Government depositary before the last day prescribed in section 3481 for payment of the tax.”

(4) **EXCESSIVE WITHHOLDING.**—Section 6401

1 (b) (relating to excessive withholding) is amended to
2 read as follows:

3 “(b) EXCESSIVE WITHHOLDING.—If the amounts al-
4 lowable as credits under section 31 (relating to credit for tax
5 withheld at source under chapter 24) and section 39 (relat-
6 ing to credit for tax withheld on interest, dividends, and
7 patronage dividends under chapter 25) exceed the taxes
8 imposed by chapter 1 against which such credits are allow-
9 able, the amount of such excess shall be considered an over-
10 payment.”

11 (5) ADJUSTMENT OF TAX; OVERPAYMENT.—

12 (A) Subsection (a) (1) of section 6413 (re-
13 lating to special credit and refund rules applicable
14 to certain employment taxes) is amended by striking
15 out “or 3402 is paid with respect to any payment
16 of remuneration,” and inserting in lieu thereof
17 “3402, 3451, 3461, or 3471 is paid with respect
18 to any payment of remuneration, interest, dividends,
19 or other amounts,”.

20 (B) Subsection (b) of such section is
21 amended—

22 (i) By striking from the heading of such
23 subsection the words “OF CERTAIN EMPLOY-
24 MENT TAXES”; and

25 (ii) By striking out “or 3402 is paid or

deducted with respect to any payment of remuneration” and inserting in lieu thereof “3402, 3451, 3461, or 3471 is paid or deducted with respect to any payment of remuneration, interest, dividends, or other amounts”.

(C) The following new subsection is added at the end of such section:

“(e) CROSS REFERENCES.—

“For special refunds or credits of tax withheld on interest, dividends, or patronage dividends under chapter 25, see sections 3484, 3485, 3486, 3487, and 3505.”

(D) The heading for such section is amended to read as follows:

“SEC. 6413. SPECIAL RULES APPLICABLE TO CERTAIN TAXES UNDER SUBTITLE C.”

(E) The table of sections for subchapter B of chapter 65 is amended by striking out

“Sec. 6413. Special rules applicable to certain employment taxes.”

and inserting in lieu thereof

“Sec. 6413. Special rules applicable to certain taxes under subtitle C.”

(6) OVERPAYMENT NOT DEDUCTED AND WITHHELD.—Section 6414 (relating to income tax withheld) is amended by striking “chapter 3” and inserting in lieu thereof “chapter 3 or 25”.

1 (7) TIME TAX CONSIDERED PAID.—Section 6513
2 (b) (relating to time tax considered paid) is amended
3 by adding at the end thereof the following new sen-
4 tences: “For purposes of section 6511 or 6512, any
5 tax deducted and withheld under chapter 25 which is
6 allowable under section 39, 3484, 3485, or 3486
7 as a credit against tax or as a refund of an overpayment
8 (or an amount treated as an overpayment) of the tax
9 imposed by chapter 1 shall, in respect of the person en-
10 titled to such credit or refund, be deemed to have been
11 paid by him on the last day prescribed for filing the re-
12 turn (determined without regard to any extension of
13 time for filing such return) of tax under chapter 1 for
14 his taxable year in which the amount subject to with-
15 holding under chapter 25 is received by him or, if such
16 person has no taxable year, on the fifteenth day of the
17 fifth calendar month following the close of such person’s
18 annual accounting period within which such amount
19 is received by him. In the case of an amount allowable
20 as a credit under section 39 (b) to the parent of a child,
21 such amount shall, if claimed by the parent, be deemed
22 to have been paid on the last day for filing his return
23 (determined without regard to any extension of time
24 for filing such return) for his taxable year which begins
25 with or within the calendar year in which amounts sub-

ject to withholding under chapter 25 were received by the child.”

(8) FAILURE TO PAY ESTIMATED INCOME TAX.—

(A) INDIVIDUALS.—Subsections (e) and (f) of section 6654 (relating to failure by individual to pay estimated income tax) are amended to read as follows:

“(e) APPLICATION OF SECTION IN CASE OF WITHHELD TAXES.—For purposes of applying this section—

“(1) the estimated tax shall be computed without any reduction for amounts which the individual estimates as his credits under section 31 (relating to tax withheld at source on wages) and section 39 (relating to tax withheld on interest, dividends, and patronage dividends); and

“(2) the amount of the credits allowed under sections 31 and 39 for the taxable year shall be deemed a payment of estimated tax, and an equal part of such amount shall be deemed paid on each installment date (determined under section 6153) for such taxable year, unless the taxpayer establishes the dates on which all amounts were actually withheld (or in the case of amounts described in section 39 (c) (1), were treated as withheld), in which case the amounts so withheld

1 shall be deemed payments of estimated tax on such
2 dates.

3 “(f) TAX COMPUTED AFTER APPLICATION OF
4 CREDITS AGAINST TAX.—For purposes of subsections (b)
5 and (d), the term ‘tax’ means the tax imposed by chapter
6 1 reduced by the credits against tax allowed by part IV of
7 subchapter A of chapter 1, other than the credits against
8 tax provided by section 31 (relating to tax withheld on
9 wages) and section 39 (relating to tax withheld on interest,
10 dividends, and patronage dividends).”

11 (B) CORPORATIONS.—Section 6655 (relating
12 to failure by corporation to pay estimated income
13 tax) is amended—

14 (i) by striking out the period at the end
15 of subsection (e) (2) (B) and inserting in lieu
16 thereof “, other than the credit against tax
17 provided by section 39 (relating to tax with-
18 held on interest, dividends, and patronage divi-
19 dends).”; and

20 (ii) by redesignating subsection (f) as
21 subsection (g) and inserting after subsection
22 (e) the following new subsection:

23 “(f) APPLICATION OF SECTION IN CASE OF TAX
24 WITHHELD ON INTEREST, DIVIDENDS, AND PATRONAGE
25 DIVIDENDS.—For purposes of applying this section—

1 “(1) the estimated tax shall be computed without
2 any reduction for the amount which the corporation
3 estimates as its credit under section 39 (relating to tax
4 withheld on interest, dividends, and patronage divi-
5 dends) ; and

6 “(2) the amount of the credit allowed under sec-
7 tion 39 for the taxable year shall be deemed a payment
8 of estimated tax, and an equal part of such amount shall
9 be deemed paid on each installment date (determined
10 under section 6154) for such taxable year, unless the
11 corporation establishes the dates on which all amounts
12 were actually withheld (or in the case of amounts de-
13 scribed in section 39 (c) (1) , were treated as withheld) ,
14 in which case the amounts so withheld shall be deemed
15 payments of estimated tax on such dates.”

16 (9) PENALTY FOR FILING FRAUDULENT EXEMP-
17 TION CERTIFICATE.—Section 7205 (relating to fraudu-
18 lent withholding exemption certificate or failure to sup-
19 ply information) is amended by adding the following
20 new sentence at the end thereof: “Any person who
21 willfully files an exemption certificate with any with-
22 holding agent under section 3483, on which the certifica-
23 tion is known by him to be fraudulent or to be false as
24 to any material matter, or who is required to file a notice

1 under subsection (a) (3) (B) of section 3483 and who
2 willfully fails to provide such notice in the manner, at
3 the time, and showing the information required under
4 such subsection (a) (3) (B), or the regulations pre-
5 scribed thereunder, shall, in lieu of any penalty otherwise
6 provided, upon conviction thereof, be fined not more than
7 \$500, or imprisoned not more than 1 year, or both.”

8 (10) OFFENSES WITH RESPECT TO COLLECTED
9 TAXES.—The last sentence of section 7215 (b) (relating
10 to offenses with respect to collected taxes) is amended to
11 read as follows: “For purposes of paragraph (2), a lack
12 of funds existing immediately after the payment of wages
13 or amounts subject to withholding under chapter 25
14 (whether or not created by the payment of such wages
15 or amounts) shall not be considered to be circumstances
16 beyond the control of a person.”

17 (11) DEFINITION OF WITHHOLDING AGENT.—Sec-
18 tion 7701 (a) (16) (defining the term “withholding
19 agent”) is amended by striking out “or 1461” and in-
20 serting in lieu thereof “1461, 3451, 3461, or 3471”.

21 (f) EFFECTIVE DATES.—

22 (1) GENERAL RULE.—Except as provided in para-
23 graph (2), the provisions of this section shall apply in
24 the case of interest and dividends paid on or after Jan-
25 uary 1, 1963.

1 (2) SPECIAL RULES.—

2 (A) In the case of transferable obligations de-
3 scribed in paragraph (1) or (6) of section 3452 (a)
4 of the Internal Revenue Code of 1954, the provi-
5 sions of this section shall apply only to interest paid
6 with respect to interest-payment periods commenc-
7 ing on or after January 1, 1963.

8 (B) The provisions of this section shall apply
9 to amounts described in section 3472 of such Code
10 paid on or after January 1, 1963, with respect to
11 patronage occurring on or after the first day of the
12 first taxable year of the cooperative beginning on
13 or after January 1, 1963.

14 **SEC. 20. INFORMATION WITH RESPECT TO CERTAIN FOR-**
15 **EIGN ENTITIES.**

16 (a) INFORMATION TO BE FURNISHED BY INDIVID-
17 UALS, DOMESTIC CORPORATIONS, ETC., WITH RESPECT
18 TO CERTAIN FOREIGN CORPORATIONS.—Section 6038 is
19 amended to read as follows:

20 **“SEC. 6038. INFORMATION WITH RESPECT TO CERTAIN**
21 **FOREIGN CORPORATIONS.**

22 “(a) REQUIREMENT.—

23 “(1) IN GENERAL.—Every United States person
24 shall furnish, with respect to any foreign corporation
25 which such person controls (within the meaning of

1 subsection (d) (1)), such information as the Secretary
2 or his delegate may prescribe by regulations relating to—

3 “ (A) the name, the principal place of busi-
4 ness, and the nature of business of such foreign
5 corporation, and the country under whose laws
6 incorporated;

7 “ (B) the accumulated profits (as defined in
8 section 902 (c)) of such foreign corporation, in-
9 cluding the items of income (whether or not in-
10 cluded in gross income under chapter 1) , deductions
11 (whether or not allowed in computing taxable in-
12 come under chapter 1) , and any other items taken
13 into account in computing such accumulated profits;

14 “ (C) a balance sheet for such foreign corpora-
15 tion listing assets, liabilities, and capital;

16 “ (D) transactions between such foreign cor-
17 poration and—

18 “ (i) such person,

19 “ (ii) any other corporation which such
20 person controls, and

21 “ (iii) any United States person owning,
22 at the time the transaction takes place, 10 per-
23 cent or more of the value of any class of stock
24 outstanding of such foreign corporation; and

25 “ (E) a description of the various classes of

1 stock outstanding, and a list showing the name and
2 address of, and number of shares held by, each
3 United States person who is a shareholder of record
4 owning at any time during the annual accounting
5 period 5 percent or more in value of any class of
6 stock outstanding of such foreign corporation.

7 The Secretary or his delegate may also require the fur-
8 nishing of any other information which is similar or
9 related in nature to that specified in the preceding
10 sentence.

11 “(2) PERIOD FOR WHICH INFORMATION IS TO BE
12 FURNISHED, ETC.—The information required under para-
13 graph (1) shall be furnished for the annual accounting
14 period of the foreign corporation ending with or within
15 the United States person’s taxable year. The informa-
16 tion so required shall be furnished at such time and in
17 such manner as the Secretary or his delegate shall by
18 regulations prescribe.

19 “(3) LIMITATION.—No information shall be re-
20 quired to be furnished under this subsection with respect
21 to any foreign corporation for any annual accounting
22 period unless such information was required to be fur-
23 nished under regulations in effect on the first day of such
24 annual accounting period.

1 “(b) EFFECT OF FAILURE TO FURNISH INFORMA-
2 TION.—

3 “(1) IN GENERAL.—If a United States person fails
4 to furnish, within the time prescribed under paragraph
5 (2) of subsection (a), any information with respect to
6 any foreign corporation required under paragraph (1)
7 of subsection (a), then—

8 “(A) in applying section 901 (relating to
9 taxes of foreign countries and possessions of the
10 United States) to such United States person for the
11 taxable year, the amount of taxes (other than taxes
12 reduced under subparagraph (B)) paid or deemed
13 paid (other than those deemed paid under section
14 904 (d)) to any foreign country or possession of the
15 United States for the taxable year shall be reduced
16 by 10 percent, and

17 “(B) in applying sections 902 (relating to
18 foreign tax credit for corporate stockholder in
19 foreign corporation) and 957 (relating to special
20 rules for foreign tax credit) to any such United
21 States person which is a corporation (or to any per-
22 son who acquires from any other person any portion
23 of the interest of such other person in any such foreign
24 corporation, but only to the extent of such portion)
25 for any taxable year, the amount of taxes paid or

1 deemed paid by each foreign corporation with re-
2 spect to which such person is required to furnish
3 information during the annual accounting period or
4 periods with respect to which such information is
5 required under paragraph (2) of subsection (a)
6 shall be reduced by 10 percent.

7 If such failure continues 90 days or more after notice
8 by the Secretary or his delegate to the United States
9 person, then the amount of the reduction under this
10 subsection shall be 10 percent plus an additional 5 per-
11 cent for each 3-month period, or fraction thereof, dur-
12 ing which such failure to furnish information continues
13 after the expiration of such 90-day period.

14 “(2) SPECIAL RULES.—

15 “(A) No taxes shall be reduced under this sub-
16 section more than once for the same failure.

17 “(B) For purposes of this subsection, the time
18 prescribed under paragraph (2) of subsection (a)
19 to furnish information (and the beginning of the
20 90-day period after notice by the Secretary) shall
21 be treated as being not earlier than the last day on
22 which (as shown to the satisfaction of the Secretary
23 of his delegate) reasonable cause existed for failure
24 to furnish such information.

25 “(C) In applying subsections (a) and (b) of

1 section 902, and in applying subsection (a) of sec-
2 tion 956, the reduction provided by this subsec-
3 tion shall not apply for purposes of determining the
4 amount of accumulated profits in excess of in-
5 come, war profits, and excess profits taxes.

6 “(c) TWO OR MORE PERSONS REQUIRED TO FURNISH
7 INFORMATION WITH RESPECT TO SAME FOREIGN COR-
8 PORATION.—Where, but for this subsection, two or more
9 United States persons would be required to furnish informa-
10 tion under subsection (a) with respect to the same foreign
11 corporation for the same period, the Secretary or his dele-
12 gate may by regulations provide that such information shall
13 be required only from one person. To the extent practicable,
14 the determination of which person shall furnish the informa-
15 tion shall be made on the basis of actual ownership of stock.

16 “(d) DEFINITIONS.—For purposes of this section—

17 “(1) CONTROL.—A person is in control of a cor-
18 poration if such person owns stock possessing more than
19 50 percent of the total combined voting power of all
20 classes of stock entitled to vote, or more than 50 per-
21 cent of the total value of shares of all classes of stock,
22 of a corporation. If a person is in control (within the
23 meaning of the preceding sentence) of a corporation

1 which in turn owns more than 50 percent of the total
2 combined voting power of all classes of stock entitled to
3 vote of another corporation, or owns more than 50 per-
4 cent of the total value of the shares of all classes of stock
5 of another corporation, then such person shall be
6 treated as in control of such other corporation. For
7 purposes of this paragraph, the rules prescribed by
8 section 318 (a) for determining ownership of stock
9 shall apply; except that clause (i) of section 318 (a)
10 (2) (C) shall be applied without regard to the 50 per-
11 cent limitation contained in such section.

12 “(2) ANNUAL ACCOUNTING PERIOD.—The annual
13 accounting period of a foreign corporation is the annual
14 period on the basis of which such corporation regularly
15 computes its income in keeping its books.

16 “(e) CROSS REFERENCES.—

 “(1) For provisions relating to penalties for violations
 of this section, see section 7203.

 “(2) For definition of the term ‘United States person’,
 see section 7701(a)(30).”

17 (b) INFORMATION AS TO ORGANIZATION OR REOR-
18 GANIZATION OF FOREIGN CORPORATIONS AND AS TO AC-
19 QUISSIONS OF THEIR STOCK.—Section 6046 (relating to

1 returns as to creation or organization, or reorganization, of
2 foreign corporations) is amended to read as follows:

3 **“SEC. 6046. RETURNS AS TO ORGANIZATION OR REORGAN-**
4 **IZATION OF FOREIGN CORPORATIONS AND**
5 **AS TO ACQUISITIONS OF THEIR STOCK.**

6 “(a) REQUIREMENT OF RETURN.—A return comply-
7 ing with the requirements of subsection (b) shall be made
8 by—

9 “(1) each United States citizen or resident who
10 is an officer or director of a foreign corporation on Jan-
11 uary 1, 1963, or who becomes such an officer or director
12 at any time after such date,

13 “(2) each United States person who on January
14 1, 1963, owns 5 percent or more in value of the stock
15 of a foreign corporation, or who, at any time after such
16 date—

17 “(A) acquires stock which, when added to any
18 stock owned on January 1, 1963, has a value equal
19 to 5 percent or more of the value of the stock of a
20 foreign corporation, or

21 “(B) acquires an additional 5 percent or more
22 in value of the stock of a foreign corporation, and

23 “(3) each person who at any time after January 1,
24 1963, becomes a United States person while owning

1 5 percent or more in value of the stock of a foreign
2 corporation.

3 “(b) FORM AND CONTENTS OF RETURNS.—The re-
4 turns required by subsection (a) shall be in such form and
5 shall set forth, in respect of the foreign corporation, such
6 information as the Secretary or his delegate prescribes by
7 forms or regulations as necessary for carrying out the pro-
8 visions of the income tax laws.

9 “(c) OWNERSHIP OF STOCK.—For purposes of subsec-
10 tion (a) (2) and (3), stock owned directly or indirectly by
11 a person (including, in the case of an individual, stock owned
12 by members of his family) shall be taken into account. For
13 purposes of the preceding sentence, the family of an indi-
14 vidual shall be considered as including only his brothers
15 and sisters (whether by the whole or half blood), spouse,
16 ancestors, and lineal descendants.

17 “(d) TIME FOR FILING.—Any return required by sub-
18 section (a) shall be filed on or before the 90th day after
19 the day on which, under any provision of subsection (a), the
20 United States citizen, resident, or person becomes liable to
21 file such return.

22 “(e) CROSS REFERENCE.—

**“For provisions relating to penalties for violations of
 this section, see sections 6678 and 7203.”**

1 (c) CIVIL PENALTY FOR FAILURE TO FILE RETURN.—

2 Subchapter B of chapter 68 (relating to assessable penal-
3 ties) is amended by adding at the end thereof the following
4 new section:

5 “SEC. 6678. FAILURE TO FILE RETURNS AS TO ORGANIZA-
6 TION OR REORGANIZATION OF FOREIGN
7 CORPORATIONS AND AS TO ACQUISITIONS
8 OF THEIR STOCK.

9 “(a) CIVIL PENALTY.—In addition to any criminal
10 penalty provided by law, any person required to file a return
11 under section 6046 who fails to file such return at the time
12 provided in such section, or who files a return which does
13 not show the information required pursuant to such section,
14 shall pay a penalty of \$1,000, unless it is shown that such
15 failure is due to reasonable cause.

16 “(b) DEFICIENCY PROCEDURES NOT TO APPLY.—Sub-
17 chapter B of chapter 63 (relating to deficiency procedure
18 for income, estate, and gift taxes) shall not apply in respect
19 of the assessment or collection of any penalty imposed by
20 subsection (a).”

21 (d) TECHNICAL AMENDMENTS.—

22 (1) Section 318(b) (relating to cross references)
23 is amended by striking out “and” at the end of paragraph

(5), by striking out the period at the end of paragraph (6) and inserting in lieu thereof “; and”, and by adding at the end thereof the following:

“(7) section 6038(d)(2) (relating to information with respect to certain foreign corporations).”

(2) The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by striking out

“Sec. 6046. Returns as to creation or organization, or reorganization, of foreign corporations.”

and inserting in lieu thereof

“Sec. 6046. Returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock.”

(3) The table of sections for subchapter B of chapter 68 is amended by adding at the end thereof the following:

“Sec. 6678. Failure to file returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock.”

(e) EFFECTIVE DATE.—

(1) The amendments made by subsection (a) shall apply with respect to annual accounting periods of foreign corporations beginning after December 31, 1962.

(2) The amendments made by subsection (b) shall take effect on January 1, 1963.

1 SEC. 21. TREATIES.

2 Section 7852 (d) of the Internal Revenue Code of 1954
3 (relating to treaty obligations) shall not apply in respect of
4 any amendment made by this Act.

87TH CONGRESS
2d Session

H. R. 10650

A BILL

To amend the Internal Revenue Code of 1954
to provide a credit for investment in certain
depreciable property, to eliminate certain
defects and inequities, and for other pur-
poses.

By Mr. MULLS

MARCH 12, 1962

Referred to the Committee on Ways and Means

Mar 15, 1962

14. UNITED NATIONS. Both Houses received the President's annual report covering U. S. participation in the United Nations during 1960 (H. Doc. 202). pp. 3813, 3912
15. FOREIGN AID. Sen. McGee inserted an editorial, "Fear and Foreign Aid." pp. 3834-5
16. MONOPOLIES. Sen. Kefauver submitted for printing a report of the Judiciary Committee, "Antitrust and Monopoly Activities, 1961" (S. Rept. 1304). p. 3819
17. INTERGOVERNMENTAL RELATIONS. Sens. Ervin, Mundt, and Muskie were reappointed members of the Commission on Intergovernmental Relations. p. 3890

ITEMS IN APPENDIX

18. RESEARCH. Extension of remarks of Sen. Carroll inserting his statement before the Senate Appropriations Committee urging funds for the Cooperative Fishery Research Unit at Colorado State University, and for a fish pesticide laboratory at Ft. Collins, Colorado. pp. A1968, A1975
19. FOREIGN TRADE. Extension of remarks of Sen. Kefauver inserting an article and stating that it "shows why U. S. partnership with the Common Market would be really a blessing, not a curse as some would have us believe." pp. A1972-4
20. FOREST SERVICE. Extension of remarks of Rep. McIntire commending Richard McArdle, Chief of the Forest Service, for "his...personal integrity and leadership," and Secretary Freeman for his appointment of a "capable career man, Ed. Cliff, to succeed Chief McArdle." pp. A1978-9
21. TAXATION. Extension of remarks of Rep. Dominick inserting an article, "Administration's Tax Aid: Just Adding to Business Burdens." p. A1979
22. RURAL LIBRARIES. Extension of remarks of Rep. Elliott giving a summation of the accomplishments under the rural Library Services Act. pp. A1988-9
23. PUBLIC WELFARE. Extension of remarks of Rep. Green discussing the provisions of H. R. 10606, to extend and improve the public assistance and child welfare services programs of the Social Security Act. p. A2003
24. DAIRY. Extension of remarks of Rep. Flood inserting an article, "His Dairy's All Dairy--Forty Fort Man Went from Milker to State Inspector While Serving Over 50 Years in Milk Industry." pp. A2016-7
25. PERSONNEL; PAY. Extension of remarks of Rep. Roudebush criticizing the administration's proposed salary increase bill, saying, "This pay raise, mislabeled a pay reform, offers tremendous salary boosts to high grades of employees, but little or no help for the low paid Government workers," and inserting an article "The Case of Federal Pay Increases." pp. A2021-2
26. WATER POLLUTION. Extension of remarks of Rep. Tollefson criticizing HEW's recent decision on water pollution by the pulp and paper industry on Puget Sound, and inserting an editorial, "After a Quick Look." p. A2004
27. FARM PROGRAM. Extension of remarks of Rep. Hoeven inserting the results of an opinion poll by the Farm Journal on the farm program and several alternatives. pp. A2009-10

28. CONSERVATION PROGRAM. Extension of remarks of Rep. Elliott discussing the agricultural conservation program and urging "a \$250 million advanced authorization for the agricultural conservation program in 1963 in lieu of the \$150 million requested in the President's budget." p. A2011

BILLS INTRODUCED

29. COOPERATIVES; TAXATION. H. R. 10650, by Rep. Mills, the proposed Revenue Act of 1962; to Ways and Means Committee (Mar. 12). The bill provides that a cooperative will be permitted to take a deduction for cash dividends or dividends paid in the form of written notices of allocation (so-called script). A written notice of allocation will be deductible only if it is either payable in cash within 90 days at the option of the patron or the patron has consented to include the amount of this written allocation in his own income. The consent of the patron may be a written consent which may be given and remain in effect unless it is revoked, or the patron who is a member of the cooperative may consent to this inclusion by the cooperative adopting a bylaw requiring all patron members to pay tax on written notices of allocation. Provides that both cash dividends (other than those of consumer cooperatives) and noncash patronage dividends will be subject to a withholding tax at a rate of 20 percent, and the patron may take credit on his tax return for the amount withheld. Provides that the amounts withheld may be retained by the withholding agent until 1 month after the end of the quarter in which the dividends or interest are paid.
30. REA. S. 3001, by Sen. Hill, to amend the definition of the term "telephone service" as used in title II of the Rural Electrification Act of 1936, as amended; to Agriculture and Forestry Committee.
31. RECREATION. S. 3004, by Sen. Engle, to authorize the establishment of the Whiskeytown National Recreation Area in the State of California; to Interior and Insular Affairs Committee. Remarks of Sen. Engle pp. 3820-1
32. SOYBEANS. H. R. 10761, by Rep. Findley, to support the price of soybeans; to House Agriculture Committee. Remarks of author p. 3955
33. MEAT INSPECTION. H. R. 10770, by Rep. Sullivan, to amend the Meat Inspection Act to extend its coverage in certain areas; to Agriculture Committee.
34. EMPLOYMENT. H. R. 10784, by Rep. Kowalski, to establish a Commission on Equal Employment Opportunity to encourage and enforce a policy of equal job opportunity in Federal employment, in employment under Government contracts, and in employment in programs supported or in facilities constructed by Federal grants-in-aid; to Education and Labor Committee.
35. FOREIGN TRADE. H. R. 10787, by Rep. Roosevelt, to provide that the Government of the United States shall furnish no aid or assistance to any foreign nation or citizen thereof in carrying out any activity under which American citizens will be discriminated against; to Foreign Affairs Committee.
36. FARM PROGRAM. H. R. 10788, by Rep. Cooley, to amend section 204 of the Agricultural Act of 1956; to Agriculture Committee.

REVENUE ACT OF 1962

REPORT

OF THE

COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES

TO ACCOMPANY

H.R. 10650

A BILL TO AMEND THE INTERNAL REVENUE CODE OF
1954 TO PROVIDE A CREDIT FOR INVESTMENT IN
CERTAIN DEPRECIABLE PROPERTY, TO
ELIMINATE CERTAIN DEFECTS AND
INEQUITIES, AND FOR
OTHER PURPOSES



MARCH 16, 1962.—Committed to the Committee of the Whole House
on the State of the Union and ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1962

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 and for further views of Hon. Thomas B. Curtis, see page 33.

REVENUE ACT OF 1962

MARCH 16, 1962.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. MILLS, from the Committee on Ways and Means, submitted the following

R E P O R T

[To accompany H.R. 10650]

The Committee on Ways and Means, to whom was referred the bill (H.R. 10650) to amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. GENERAL STATEMENT

This bill, H.R. 10650, represents a major revision and reform of our Federal tax system.

On the one hand the investment credit provided by this bill is designed to provide a stimulant to the economic growth of this country. This is needed both to improve our competitive position abroad and in the long run to raise our standard of living at home. On the other hand, the other provisions of this bill are designed to improve the equity of our tax structure.

Estimates presented in part II of this report indicate that when the provisions of this bill are fully effective a revenue loss of from \$505 million to \$775 million is expected, if no effect of the provisions on the national economy is taken into account. The Treasury Department has estimated, however, that when this effect is taken into account the bill will be substantially in balance.

On April 20, 1961, the President sent to Congress a message containing a series of proposals for the revision of the present tax laws. Most of his recommendations, modified as your committee believed desirable, are incorporated in this bill.

Your committee on May 3, 1961, began hearings on the President's proposals. These hearings extended over 6 weeks and the committee received testimony and comments from over 400 individuals and organizations. This material is contained in 4 volumes of over 3,600 printed pages. Following the special hearings, your committee considered the President's proposal in executive session last year for a period of several weeks. Upon completion of its considerations at that time your committee made certain *tentative* decisions for incorporation in a draft made public in order to obtain the views of interested persons. The committee print containing these suggestions was released to the public on August 24, 1961, together with a general explanation of these provisions. That print was given wide distribution. In the fall of 1961 the staff met with outside persons and worked with the Treasury Department in obtaining the views of interested parties. With the beginning of this session of Congress your committee immediately began a review of these provisions, making modifications in the earlier decisions to take into account the suggestions and recommendations received. This bill, therefore, represents the decisions reached by your committee after careful deliberation over an extended period of time.

The provisions contained in your committee's bill can be summarized as follows:

(1) An investment credit against tax liability is provided. It generally is 8 percent of investments in new tangible personal property and certain other depreciable real property exclusive of buildings. A credit also is available, however, for limited amounts of used property which is purchased.

(2) A deduction is provided for costs relating to appearances before, and communications with a legislative body, legislative committee or individual legislator, if the expenses are otherwise ordinary and necessary business expenses. However, this does not include any advertising expenses or expenses concerned with political campaigns.

(3) Deductible expenses for entertainment, amusement, or recreation generally are limited to those directly related to the active conduct of a trade or business, and in the case of facilities also to those which are primarily used for the furtherance of the taxpayer's trade or business. Limitations are also provided in the case of business gifts. In addition, rules are set forth providing that deduction of these expenses will be denied unless they are substantiated.

(4) Distributions in kind from foreign corporations are treated as having a value equal to the fair market value of the property (and not the adjusted basis of this property in the hands of the distributing corporation where this is lower).

(5) Where goods are purchased or sold by a domestic corporation to a related foreign corporation, the income arising from these transactions is to be allocated between the parties on the basis of the location of the assets used in the operations, the payroll attributable to them and the related selling expenses. This rule will not be used where an arm's-length price can be established for the purchases or sales.

(6) The passive income of a foreign personal holding company is to be taxed to the U.S. shareholders if 20 percent or more of

its income is "foreign personal holding company income"; and if 80 percent or more of its income is of this type, then the remaining income of the company also is to be taxed to the shareholders.

(7) The present tax treatment of mutual savings banks, savings and loan associations, etc., is revised so that their additions to bad debt reserves generally may not exceed 60 percent of their taxable income (before this deduction) or, if larger, an amount bringing their reserves up to 3 percent of loans.

(8) Distributions by foreign trusts, established by U.S. grantors, are to be taxed to the U.S. beneficiaries in substantially the same manner as if they had received this income directly instead of through the intermediary of a foreign trust.

(9) Mutual fire and casualty insurance companies are to be taxed on their "total" income less a deduction for loss reserves equal to one-fourth of their underwriting gain plus 1 percent of their insurance claims. Most of this reserve is not actually used to offset losses, eventually will be subject to tax.

(10) Where a domestic corporation receives dividends from a foreign corporation, the amount included in its tax base if it elects the foreign tax credit is to be, not only the dividend itself, but also the tax paid by the foreign corporation as well.

(11) The unlimited exclusion from U.S. tax of income earned abroad by U.S. citizens who are bona fide foreign residents is reduced to \$35,000 (\$20,000 for the first 3 years). In addition, the contributions which employees make hereafter toward employee pensions based on foreign employment will be taxable to the employee when received.

(12) Shareholders of controlled foreign corporations are to report for tax purposes the undistributed earnings of these corporations to the extent they represent income from insuring U.S. risks, income from patents, copyrights, and exclusive formulas or processes developed in the United States, passive types of income generally, and income from certain sales. In these latter two cases reductions in the income tax to the shareholders are allowed for investments of the income in certain businesses in less developed countries. To the extent that the shareholders are not taxed on the income of the controlled foreign corporation under the above provisions, they are to be taxed on the undistributed earnings of controlled foreign corporations which are not invested in substantially the same trade or business or invested in less developed countries in new trades or businesses or in certain controlled subsidiaries.

(13) In the case of personal property and most real estate, other than buildings, when such property is sold at a gain this gain, to the extent of depreciation taken in prior years, is to be treated as ordinary income for tax purposes.

(14) When stock in foreign investment companies is sold, the gain realized by the U.S. shareholders is to be ordinary income to the extent of the earnings and profits accumulated since 1962. The companies and shareholders can avoid this treatment if the companies distribute 90 percent or more of their taxable income, other than capital gains, and the shareholders report the capital gains whether distributed or not.

(15) Where there is a redemption or liquidation of the stock of a controlled foreign corporation or where stock in such a corporation is sold, then any gain to the extent this gain represents earnings and profits of the corporation accumulated abroad is to be taxed to the principal shareholders as ordinary income or as dividends.

(16) Cooperatives are to receive a deduction for patronage dividends paid to their patrons in cash or by allocations if the patron has the option to redeem the notices of allocation in cash within a short period of time after they are issued, or consents to treat this income as constructively received and reinvested in the cooperative. The patron may give his consent individually in writing, or the cooperative may, through its bylaws, require all members (after notification) to give this consent. Where consent is given, or where the option to receive cash was available, the patron will be required to pay taxes on the patronage dividends if they arise from business activity.

(17) Real estate located outside of the United States, in the case of citizens or residents of the United States, is to be included in their tax base for purposes of the estate tax imposed at the time of death.

(18) Withholding is provided for dividends, most interest, and patronage refunds at a rate of 20 percent. No receipts are required under this system and exemption certificates and quick refunds provide for most cases where there otherwise would be overwithholding.

(19) Additional information is to be provided the Treasury Department by corporations and other businesses engaged in foreign operations.

II. REVENUE ESTIMATES

The revenue effect of your committee's bill is shown in tables 1 through 4 below. Tables 1 and 2 are based upon income levels for the calendar year 1962, but show the estimated revenue effect of the bill when all of the changes provided by it are fully effective. Table 1 does not take into account any effect the provisions of the bill may have on economic levels generally. Table 2, on the other hand, does take such effects into account but does not reflect any change in business attitude which may be brought about by the bill. Tables 3 and 4 estimate the effect of the bill on revenues in the fiscal year 1963, with table 3 not taking into account the effect of the provisions on economic conditions and table 4 taking such effect into account.

As indicated by table 1, the investment credit taken by itself is expected to result in an annual loss of revenue (when fully effective) of \$1,800 million to \$1,875 million. The other provisions of the bill are expected, when fully effective, to offset from \$1,100 million to \$1,295 million of this loss, leaving a net loss of from \$505 million to \$775 million. As indicated in table 2, the Treasury Department expects the stimulative effect of the investment credit to substantially reduce the net revenue loss of this provision, with the result that the revenue impact of the bill, over the long run, will be substantially in balance.

The revenue loss for the fiscal year 1963 is expected to be larger than in the long run. In large part this is due to the fact that the investment credit, which is the only provision resulting in a revenue loss, is effective as of the first of 1962, while most of the other provisions, which are the provisions providing the additional revenue, are not effective until the first of 1963. As a result, it is estimated that this bill will result in a revenue loss of from \$1,425 million to \$1,550 million in the fiscal year 1963, if no effect of the provisions on the economy is taken into account. The Treasury Department has estimated that if the effect of the provisions on the economy is taken into account, the revenue loss in the fiscal year 1963 will be reduced to \$660 million.

TABLE 1.—*Estimated revenue effect of bill¹ when changes are fully effective, without taking into account the effect on the economy of the provisions*

[In millions of dollars]

	Estimates of staff of—	
	Joint Com- mittee on Internal Revenue Taxation	Treasury Department
Revenue bill of 1962:		
Investment credit.....	-1,875	-1,800
Withholding on dividends and interest.....	+550	+650
Mutual banks and savings and loan associations.....	+160	+200
Entertainment expenses.....	+125	+125
Capital gains on depreciable property.....	+110	+100
Mutual fire and casualty companies.....	² +25	+40
Cooperatives.....	+30	+35
Foreign items:		
Controlled foreign corporation.....	+50	³ +95
Gross-up of dividends.....	+25	+30
All other items relating to taxation of foreign income, etc.....	+25	+30
Total.....	-775	-505

¹ At levels of income and investment estimated for the calendar year 1962 except that the Treasury estimate of revenue gain from change in taxation of mutual banks and savings and loan associations is based on income levels for the calendar year 1963, the first year affected.

² Assumes transitional period has been completed for fire and casualty companies.

³ The revenue estimates for the controlled foreign corporation provision do not take into account additions to the tax base, in the form of royalties, rents, etc., which reliable evidence indicates will be forthcoming but which cannot be quantified with an acceptable degree of accuracy.

TABLE 2.—*Treasury Department estimates of revenue effect of bill¹ when changes are fully effective and taking into account its estimate of effect on the economy of the provisions*

[In millions of dollars]

Revenue bill of 1962:

Investment credit ²	— 900
Withholding on dividends and interest.....	+ 430
Mutual banks and savings and loan associations.....	+ 135
Entertainment expenses.....	+ 80
Capital gains on depreciable property.....	+ 50
Mutual fire and casualty companies.....	+ 25
Cooperatives.....	+ 25
Foreign items:	
Controlled foreign corporation ³	+ 85
Gross-up of dividends.....	+ 30
All other items relating to taxation of foreign income, etc.....	+ 30

Total..... — 10

¹ At levels of income and investment estimated for the calendar year 1962 except that revenue gain from change in taxation of mutual banks and savings and loan associations is based on income levels for the calendar year 1963, the first year affected.

² In estimating the net revenue cost of the investment credit, its favorable effects on the level of investment were computed from statistical relationships in past years between investment and gradual changes in the cost of capital goods (profitability) and cash flow. This procedure thus does not take into account the especially favorable impact on businessmen's decisions to invest of the sudden major improvements in these factors resulting from the enactment of the credit. Taking this into account should produce more favorable effects and a smaller net revenue loss than the table shows.

³ The revenue estimates for the controlled foreign corporation provision do not take into account additions to the tax base, in the form of royalties, rents, etc., which reliable evidence indicates will be forthcoming but which cannot be quantified with an acceptable degree of accuracy.

TABLE 3.—*Estimated revenue effect of bill for the fiscal year 1963, without taking into account the effect on the economy of the provisions*

[In millions of dollars]

	Estimates of staff of—		Effective date
	Joint Committee on Internal Revenue Taxation	Treasury Department	
Revenue bill of 1962:			
Investment credit.....	— 1,800	— 1,700	Jan. 1, 1962
Withholding on dividends and interest.....	+ 170	+ 205	Jan. 1, 1963
Mutual banks and savings and loan associations.....	+ 10		Do.
Entertainment expenses.....	+ 60	+ 65	July 1, 1962
Capital gains on depreciable property.....			Jan. 1, 1962
Mutual fire and casualty companies.....			Jan. 1, 1963
Cooperatives.....			Do.
Foreign items:			
Controlled foreign corporations.....			Do.
Gross-up of dividends.....			Do.
All other items relating to taxation of foreign income, etc.....	+ 10	+ 5	Do.
Total.....	— 1,550	— 1,425	

TABLE 4.—*Treasury Department estimates of effect of bill¹ for the fiscal year 1963 taking into account its estimate of effect on the economy of the provisions*

[In millions of dollars]

	Estimates of Treasury Department	Effective date
Revenue bill of 1962:		
Investment credit ¹	-900	Jan. 1, 1962
Withholding on dividends and interest.....	+195	Jan. 1, 1963
Mutual banks and savings and loan associations.....		Do.
Entertainment expenses.....	+40	July 1, 1962
Capital gains on depreciable property.....		Jan. 1, 1962
Mutual fire and casualty companies.....		Jan. 1, 1963
Cooperatives.....		Do.
Foreign items:		
Controlled foreign corporations.....		Do.
Gross-up of dividends.....		Do.
All other items relating to taxation of foreign income, etc.....	+5	Do.
Total.....	-660	

¹ In estimating the net revenue cost of the investment credit, its favorable effects on the level of investment were computed from statistical relationships in past years between investment and gradual changes in the cost of capital goods (profitability) and cash flow. This procedure thus does not take into account the especially favorable impact on businessmen's decisions to invest of the sudden major improvements in these factors resulting from the enactment of the credit. Taking this into account should produce more favorable effects and a smaller net revenue loss than the table shows.

III. INVESTMENT CREDIT

(Sec. 2 of the bill—new secs. 38 and 46–48 of the code)

A. Reasons for provisions

The President in his tax message to Congress last year urged the adoption of a tax incentive in the form of a credit against tax liability for certain types of investment. He renewed this request this year in both his budget message and his Economic Report.

In his Economic Report the President states—

We must scrutinize our tax system carefully to insure that its provisions contribute to the broad goals of full employment, growth, and equity.

He indicates that his legislative proposals in the tax field are directly related to these goals and the corollary need for improvement in the balance of payments. He further states:

The centerpiece of these proposals is the 8-percent tax credit against tax for gross investment in depreciable machinery and equipment. The credit should be retroactive to January 1, 1962. The tax credit increases the profitability of productive investment by reducing the net cost of acquiring new equipment. It will stimulate investment in capacity expansion and modernization, contribute to growth of our productivity and output, and increase the competitiveness of American exports in world markets.

The President also points out that the tax credit for investments is in part self-financing. He indicates that the stimulus it provides to new investments will have favorable effects on the level of economic activity during the year and that this will in turn add to Federal revenues.

The 8-percent tax credit provided by this bill is a complement to the administration's plans for revising the guidelines for the tax lives of property subject to depreciation. It is believed that the investment credit, coupled with the liberalized depreciation, will provide a strong and lasting stimulus to a high rate of economic growth and will provide an incentive to invest comparable to those available elsewhere in the rapidly growing industrial nations of the free world.

The Secretary of the Treasury has indicated that further depreciation revisions will be announced this spring. He has specified that the basic objective of these revisions is to provide realistic tax lives in the light of past actual practices and present and foreseeable technological innovations and other factors affecting obsolescence. The Secretary has stated that another facet of this objective is to achieve a more simple and flexible system of depreciation moving toward guideline lives for broad classes of assets used by each of the industries in our economy.

Realistic depreciation alone, however, is not enough to provide either the essential economic growth or to permit American industry to compete on an equal basis with the rapidly growing industrial nations of the free world. The major industrialized nations of the free world today provide not only liberal depreciation deductions but also initial allowances or incentive allowances to encourage investment and economic growth. This is true, for example, in Belgium, Canada, France, West Germany, Italy, Japan, the Netherlands, Sweden, and the United Kingdom.

The investment credit will stimulate investment because—as a direct offset against the tax otherwise payable—it will reduce the cost of acquiring depreciable assets. This reduced cost will stimulate additional investment since it increases the expected profit from their use. The investment credit will also encourage investment because it increases the funds available for investment. Generally, for each \$100 of investment business, because of the tax credit, will have \$8 more than otherwise would be the case for additional investment. Moreover, since the credit applies only to *newly acquired* assets, the incentive effect is concentrated on new investment and no revenue is lost in raising the profitability of assets already held by business firms. In addition, it is the hope of the committee that the savings from the credit itself also will be used for new investment in further advancing the economy.

The investment credit provided by this bill generally provides an offset against the tax otherwise due equal to 8 percent of the investments made. It does not affect the depreciation, which may be taken, either initially or in subsequent years. As a result the tax credit concentrates the benefit provided in the initial year of the investment, thereby maximizing the stimulative effect.

The investment credit in the case of most regulated public utilities is in effect 4 percent rather than 8 percent. The smaller credit is provided in such cases because much of its benefit in these regulated industries is likely to be passed on in lower rates to consumers, thereby negating much of the stimulative effect on investments. Moreover, the size of the investment in regulated public utilities, such as electric companies, local gas companies, telephone companies, etc., will in large part be determined by the growth of other industries, rather than their own.

In your committee's consideration of the investment credit last year it was planned to make the credit available only with respect to assets with a life of 6 years or over. However, its review this year has convinced your committee that the credit should be made available at least in part for shorter lived assets. There is a substantial volume of industrial equipment with lives of 4 and 5 years, investment in which should also be encouraged. At the same time your committee recognized that, with the more rapid turnover of short-lived assets, the plan as considered last year would have provided a substantially greater investment credit for short-lived assets than for longer lived assets. For example, in the case of a \$1,000 investment in a 4-year asset, which is replaced as it wears out, three \$80 credits could be obtained in the same time span in which one \$80 credit could be obtained in the case of a \$1,000 investment in a 12-year asset. As a result of these factors, your committee has provided that assets with lives of from 4 up to 6 years are to be taken into account in determining the allowable credit on the basis of one-third of the investment made; those with lives of from 6 up to 8 years are to be taken into account on the basis of two-thirds of the investment made; and only those with expected lives of 8 years and over will be taken into account on the basis of the full investment for purposes of the credit.

The bill, by limiting the credit principally to property which is new in use will limit the investment stimulant primarily to provision for new production facilities. However, because of the greater dependence of small business on used property, a limited credit is also made available for used property which is newly acquired.

The credit is available for investments in most tangible personal property. It also is available for limited types of real property, other than buildings. The greater emphasis is placed on equipment and machinery because it is believed the need for such investment is the major requirement of the economy.

B. General explanation of provision

1. *Summary.*—The bill provides a credit (in code sec. 38), which may be offset directly against income tax liability. The credit generally is an amount equal to 8 percent of "qualified investment" which includes both purchases of new equipment, and also, to a limited extent, purchases of used equipment. In the case of property with an expected useful life of 4 up to 8 years, the investment taken into account in computing the 8-percent credit is graduated from one-third in the case of the 4-year assets up to 100 percent in the case of property with a useful life of 8 years or more. In the case of most public utilities, however, only half of the investment as otherwise determined is included in computing the credit.

The types of property, whether new or used, which are included in qualified investment are described as "section 38 property." This property includes most tangible personal property. It also includes certain real property, other than buildings (or structural components) if the property is used directly in manufacturing, production, transportation, etc.

Once the amount of the 8-percent credit against tax is determined, the amount which may be claimed in any one year is limited to the tax liability, or if this tax liability exceeds \$100,000, the credit (to the

extent it exceeds this amount) is limited to 50 percent of the tax liability. However, a 5-year carryforward is provided for any of these credits which because of this limitation are unused. The bill also provides that where the property is disposed of before the end of its life as estimated for the credit (and this is less than 8 years) the credit is reduced to the amount which would have been allowed initially had the useful life of the asset been correctly estimated.

These provisions are described briefly below.

2. *Qualified investment*.—Investment which is eligible for the 8-percent investment credit is referred to in the bill as “qualified investment” (sec. 46(c)). Qualified investment includes both new property and a limited amount of used property. Property qualifies for the investment credit in the year it is placed in service by the taxpayer, even though under the depreciation convention used by the taxpayer, he may not be eligible to start depreciation on the property until the coming year.

The percentage of investment which the taxpayer may take into account as qualified investment varies to some degree with the expected useful life of the property in his business. No part of the investment in property with an expected useful life of less than 4 years is taken into account. Property with an expected useful life of 4 years and up to (but not including) 6 years is taken into account at one-third of the amount of the investment actually made; property with an expected useful life of 6 years and up to (but not including) 8 years is taken into account on the basis of two-thirds of the investment made; and property with a longer life is taken into account at the full amount of the investment.

Public utility property is taken into account as qualified investment at one-half of the amount otherwise allowable. Thus, in the case of 4- or 5-year public utility property, one-sixth of the investment is taken into account; in the case of 6- or 7-year property, one-third of the investment is taken into account; in the case of property with a life of 8 years or more, one-half is taken into account. This means that in the case of public utility property with an expected useful life of 8 years or more, in effect a 4-percent credit is allowed. Public utility property for this purpose means property used predominantly in an electrical energy, water or sewage disposal business, a local gas distribution business, a telephone business, or a domestic telegraph business, but only if the rates involved in all of these cases are subject to regulation by a governmental agency or commission.

3. *New and used property*.—The new property taken into account as qualified investment (sec. 48(b)), must be purchased or otherwise acquired after December 31, 1961, and its first use commenced by the taxpayer after that date. Other new property eligible for the credit also includes property constructed, reconstructed, or erected by the taxpayer after that date. These are the same rules which applied with respect to the new forms of depreciation provided in 1954.

Used property (sec. 48(c)), eligible for the credit, also must be purchased after December 31, 1961, but, of course, is not property which is new in use with the taxpayer. To prevent abuse, however, there has been omitted from the term “used property,” available for the credit that which is used by a person who used the property before such acquisition (and also that which is so used by a person who

is related to a person who used the property before its present acquisition).

The cost of any used property which may be taken into account is limited to \$50,000 a year. Where used property with varying useful lives is acquired the taxpayer may select the property to be taken into account for the investment credit. Presumably he will select assets with lives of 8 years or more since there is no one-third or two-thirds reduction in such cases.

In the case of a husband and wife filing separate returns, the amount of used property which may be taken into account by each is \$25,000 instead of \$50,000, unless one of the two has not purchased any used section 38 property, in which case the other spouse may claim the entire amount up to \$50,000. This prevents any double allowance for married couples. In the case of affiliated groups of corporations (with a 50-percent test of common ownership instead of the 80 percent usually applied), there is to be one \$50,000 used property allowance for the group and it is to be apportioned among the members of the group in accordance with their purchases of this property. In the case of partnerships, this limitation applies both at the partnership level and also with respect to each partner. Thus, \$50,000 is the limit with respect to used property which may be qualified for any partnership, and then there is a further \$50,000 limit at the partner level. This latter limit may further restrict the used property eligible for the credit where a partner, in addition to his share of investment in one partnership, has either from another partnership or as a sole proprietor, additional used property investment for which he may receive a credit. The total of these which qualify for the credit may not exceed \$50,000.

To prevent a double allowance where used property is traded in on used property, or where used property is disposed of and other used property "similar or related in service or use" is acquired as a replacement, the cost otherwise allowable for the used property acquired is reduced by the adjusted basis of the property disposed of in both of these types of cases. However, this "replacement" reduction in the credit is not to apply where there otherwise is a reduction in the credit for the property disposed of because of its disposal within 8 years and before the end of what had been its estimated useful life. (See heading 5 below.)

4. "*Section 38*" *property*.—Section 38 property (defined in sec. 48(a)), is the only property (either new or used) which is treated as "qualified investment." Except for the exclusions noted below, all tangible personal property qualifies as section 38 property. Except for buildings and their structural components, real property which is used as an integral part of manufacturing, production or extraction or of furnishing transportation, communications, electrical energy, gas, water or sewage disposal services also qualifies as section 38 property. This is also true of real property (other than buildings and structural components) used for research or storage facilities with respect to any of the above categories. Tangible personal property is not intended to be defined narrowly here, nor to necessarily follow the rules of State law. It is intended that assets accessory to a business such as grocery store counters, printing presses, individual air-conditioning units, etc., even though fixtures under local law, are

to qualify for the credit. Similarly, assets of a mechanical nature, even though located outside a building, such as gasoline pumps, are to qualify for the credit. Real property (other than buildings and structural components) which qualifies as integral parts of categories referred to above includes such assets as blast furnaces, oil and gas pipelines, railroad track and signals, and fences used in connection with raising cattle.

Section 38 property must be depreciable property and have a useful life of 4 years or more. As indicated elsewhere, property with estimated useful lives of from 4 to 8 years is only partially taken into account for purposes of the investment credit.

There also are certain categories of property which are excluded from the definition of section 38 property and, therefore, cannot qualify for the credit. These exclusions are:

(1) Property used predominantly to furnish lodging or in connection with the furnishing of lodging. However, there are two exceptions to this exclusion. First, property used in nonlodging commercial facilities (such as a restaurant) located in lodging facilities (such as a hotel) may qualify for the credit if the nonlodging commercial facilities are available for use by the general public on the same basis as for the lodgers. Second, property used in a hotel or motel which primarily serves transient guests may qualify for the credit. The first of these two rules is essential to place nonlodging commercial facilities located in an apartment building, etc., on an equal competitive basis with similar facilities located elsewhere. The allowance of the credit in the case of a hotel or motel also is used in a regular commercial venture and, therefore, it was believed that it too should be eligible for the investment credit.

(2) Property used by a tax-exempt organization (other than in a business to which the unrelated business income tax applies). The limitation on the allowance of the credit in this case is designed to prevent an investment for use in connection with an exempt function from decreasing any tax on an unrelated trade or business.

(3) Property used by governmental units. Property leased to governmental units is omitted since allowing the lessor in such cases an investment credit would not be expected to increase the use of such property by the governmental units.

(4) Property used predominantly outside of the United States. However, there are certain exceptions where this type of property is eligible for the credit, namely, in the case of domestically owned aircraft, rolling stock of railroads, vessels and motor vehicles, where the use is partially within and partially without the United States. Similarly, an exception is made for domestically owned containers which are used in the transportation of property to or from the United States. A further exception is made for domestically owned property used in exploring for, developing, removing, or transporting natural resources from the Outer Continental Shelf of the United States. Property used predominantly outside of the United States (with the exceptions noted) is omitted, since the primary purpose of the credit is to encourage investment within the United States.

5. *Limitation on tax credit.*—The tax credit, under your committee's bill (sec. 46(a)(2)) may not exceed the tax liability, or if the tax liability is in excess of \$100,000, may not exceed \$100,000 plus 50 percent of the tax liability over this amount. This limitation, while leaving substantial leeway for utilizing the credit, is designed to prevent it (in combination with other tax credits) from relieving the taxpayer from any substantial tax contribution. However, in recognition of the problems of small business, the bill does not impose this limitation with respect to the first \$100,000 of any tax liability.

Although this limitation with respect to the allowance of the investment credit is imposed for the year in which the investment is made, nevertheless, any investment credit which, because of this limitation, cannot be used in the current year may be carried forward by the taxpayer and used in any of the succeeding 5 years if the credit in any such year is less than the tax limitation.

Tax liability for purposes of this limitation is computed without regard to the accumulated earnings tax or personal holding company tax liability, but after the application of the foreign tax credit, the 4-percent dividends-received credit, the credit for partially tax-exempt interest and the retirement income credit. In order to prevent a full allowance with respect to \$200,000 of tax liability in the case of a married couple, the bill provides that for a married individual filing a separate return the tax liability limitation is \$50,000 instead of \$100,000. However, if either the husband or the wife has no qualified investment (or unused credit carryover), the one having the investment or carryover may make use of the entire \$100,000. In the case of an affiliated group there is one \$100,000 of tax liability which can be fully offset by qualified investment and this is by regulations to be apportioned among the members of the affiliated group.

6. *Certain dispositions of section 38 property.*—To guard against a quick turnover of assets by those seeking multiple credit,—the bill provides (in sec. 47) a special adjustment. Under this provision if property is disposed of, or otherwise ceases to be section 38 property, the tax for the current year is to be increased by the reductions in investment credits (which would have resulted in the prior years) had the investment credits allowable been determined on the basis of the *actual* useful life of the property rather than its *estimated* useful life. This means, for example, that if an asset which had previously been estimated to have a useful life in the business of 8 years or more actually is used by the taxpayer only for 6 years, the investment credit for the year in which the investment was originally made will be recomputed on the basis of two-thirds the investment made. Had this asset been sold after 4 or 5 years' use, the allowable investment would have been recomputed on the basis of one-third of the actual investment and had it been sold after a still shorter period, no credit at all would have been allowed.

Although the credit is recomputed for the earlier year in which the investment was made, the actual adjustment in tax occurs in the current year, namely, the year in which the asset is disposed of (or otherwise ceases to be sec. 38 property). This makes it unnecessary actually to recompute taxes in the prior years, or to extend the statutory periods of limitations. An adjustment is also made in any carryovers of unused credits so that they too will reflect the reduced amount of investment to be taken into account.

Although disposal of assets within a shorter period of time than their estimated useful life (where this is less than 8 years) usually will be the factor resulting in downward adjustments in the credit allowed, the credit must also be adjusted if property ceases to qualify as section 38 property; where, for example, its use becomes predominantly outside of the United States. A downward adjustment in the credit also is required where property is converted to public utility property for which only a reduced credit is available. As indicated previously, a credit is allowed for certain types of public utility property equal only to half of the credit generally allowable. Where property is converted to such use (again, before the end of its estimated useful life and within the 8-year period) a downward adjustment must be made. In this case, however, instead of disqualifying one-third, two-thirds, or all of the property, depending upon the period of time involved before the conversion to public utility use is made, one-half of such an adjustment is made, since the public utility property itself qualifies for the credit for the remaining period of time but on a reduced basis.

Few exceptions are made to the adjustment rule for the credit described above because in no case does this result in a lesser credit than would be available had the useful life of the property been estimated accurately. Moreover, since the tax increase occurs in the current year, and not with respect to the prior year in which the investment occurred, no interest is charged with respect to the increase in tax resulting from the reduction in credit. As a result, your committee believed that it was necessary to forego the application of the adjustment rule only in the case of the transfer of property by reason of the death of the taxpayer or in the case of corporations where a successor corporation "stands in the shoes" of the predecessor corporation. The successor corporation in such a case, of course, must continue to hold the property for the appropriate period of time, or an increase will be made in its tax because of the disposition of the property prior to the end of its estimated useful life.

7. *Election for leased property.*—The bill provides (in sec. 48(d)) that a person engaged in the business of leasing property may elect with respect to new property to treat the investment as if made by the lessee instead of the lessor. This election applies only with respect to new property and is not available for used property. Permitting the investment credit to be passed on to the lessee in these cases is believed to be desirable since, as a result of this provision, it is possible for the lessor to pass the benefit of the investment credit on to the party actually generating the demand for the investment.

If the lessor makes this election, then the lessee is treated for purposes of this provision as if he had acquired the property himself, that is, generally he will be treated as if he had acquired the property for the lessor's cost or other basis for the property. However, if the lessor constructed the property (or a corporation controlled by or which controlled the lessor did so) the lessee is treated as having acquired the property for its fair market value. The useful life of the property in the hands of the lessee in such cases is to be its useful life in the hands of the lessor for purposes of computing the size of the credit available. This is true whether or not the lease itself is for a shorter period of time. Of course, in such cases if the lessee does not renew the lease and hold the property for the estimated useful

life of the property in the hands of the lessor, then a downward adjustment will be made in his investment credit.

8. *Special classes of taxpayers.*—A number of special categories of taxpayers receive special tax treatment under the Internal Revenue Code which makes it inappropriate in their cases to allow the full investment credit. For other taxpayers, the code provides that income may be taxed in part to the organization and in part to its shareholders or beneficiaries. In these situations your committee's bill either cuts down the allowance of the tax credit in proportion to the special benefit received, or provides for the apportioning of the investment credit between the organization and its shareholders or beneficiaries in accordance with their sharing of income for tax purposes. Similar adjustments are also provided in the \$100,000 tax liability limitation.

In the case of mutual savings banks, building and loan associations and cooperative banks, the investment credit allowable is reduced by 50 percent (largely offsetting the 60 special deductions they are allowed). The \$100,000 tax liability limitation is also similarly reduced for these organizations.

In the case of regulated investment companies and real estate investment trusts, the qualified investment allowed them and the applicable \$100,000 tax liability limitation are reduced in the same proportion in which their taxable income is reduced by dividends paid to shareholders or beneficiaries. Similarly, in the case of cooperatives, the qualified investment and \$100,000 tax liability limitation to be taken into account are reduced in the same proportion in which their taxable income is reduced for patronage dividends (and in the case of exempt cooperatives its deductions for dividend payments on capital stock, patronage distributions with respect to U.S. business and income distributed to patrons from sources other than patronage).

In the case of subchapter S corporations, i.e., corporations treated in a manner similar to that of partnerships, since it is the shareholders, rather than the corporation, who are taxed on the income of the corporation, the bill (sec. 48(c)) divides the qualified investment for each year on a pro rata basis among the shareholders of the corporation at the end of the year. In this case since the shareholders are treated as the taxpayer, the investment maintains its character as new or used section 38 property in their hands. Similarly, the bill (in sec. 48(f)) provides that qualified investment in the case of estates or trusts is to be apportioned between the estate or trust on one hand and the beneficiaries on the other on the basis of the income of the estate or trust allocable to each. As in the case of the subchapter S corporations, the beneficiary is treated as the taxpayer with respect to the investment apportioned to him and therefore the investment retains its character in his hands as new or used section 38 property. The \$100,000 tax liability limitation in the case of the estate or trust is reduced in proportion to the total income allocated to other than the estate or trust.

9. *Carryovers in the case of certain corporate acquisitions.*—Generally, in the case of certain tax-free acquisitions of assets of one corporation by another, present law provides that certain items of the first corporation are to be carried over and attributed to the second. This includes such items as net operating loss carryovers, earnings and

profits, methods of accounting, methods of computing depreciation allowance, etc. The bill adds to this list (sec. 381(c)(23)) a carryover to the acquiring corporation in the case of these tax-free reorganizations of the status of the prior corporation with respect to items required to be taken into account for purposes of the investment credit. This mainly is concerned with (1) the carryover of the possibility of adjustment with respect to the investment credit where an asset is held for less than the full period of its estimated useful life and (2) the carryover of any unused investment credit in the prior 5 years.

10. *Effective date.*—The bill provides that the investment credit is to apply to taxable years ending after December 31, 1961. However, in the definition of new section 38 property and also used section 38 property (the only types of property eligible for the credit) it is provided that a credit is to be available only with respect to acquisitions after December 31, 1961, or in the case of new property only with respect to the portion of the property which is constructed, reconstructed or erected after that date. The combination of the effective date and these definitions of new and used section 38 property in effect provide that the investment credit is to be available only with respect to property acquired (or in the case of new property also constructed, reconstructed, or erected) after December 31, 1961, with respect to taxable years ending after that date.

IV. APPEARANCES, ETC., WITH RESPECT TO LEGISLATION

(Sec. 3 of the bill—sec. 162(e) of the code)

A. *Reasons for provision*

Present law allows deductions for income tax purposes for ordinary and necessary expenses paid or incurred in carrying on a trade or business. No mention, however, is made in the statute of expenses incurred in making appearances, submitting material, or communicating with respect to legislative matters. However, Treasury regulations in effect prior to the enactment of the 1954 Code disallowed deductions for expenditures for such purposes (regulations 118, secs. 39.23(o)-1(f) and 39.23(q)-1(a)).

In 1959, the Supreme Court handed down two companion decisions upholding the validity of these regulations, *Cammarano v. U.S.* and *F. Straus & Sons, Inc. v. U.S.* (358 U.S. 498 (1959)). The Court held that although the amounts expended for legislative matters were "ordinary and necessary"—in fact essential to the very survival of the taxpayer's business—nevertheless they were not deductible because the regulations barred the deduction of this particular type of expense. The court recognized that the statute contained no provisions specifically supporting the regulations, but stated that they had acquired the force of law by reason of congressional reenactment of the underlying statute.

Following the *Cammarano* decision, the Treasury Department promulgated new regulations relating to deductions incurred with respect to legislative matters. These regulations, while following the general rules set forth in the earlier regulations for the first time stated specifically that several different classes of expenditures are to be disallowed as deductions. For example, the new regulations require

the disallowance of a deduction for the portion of dues and other payments to any organization, a "substantial part" of the activities of which consist of lobbying to the extent that such amounts are "attributable to" these activities. Similarly, the regulations now state that expenditures for the promotion or defeat of legislation include expenditures for the purpose of attempting to influence members of a legislative body directly or indirectly, by urging or encouraging the public to contact the members.

The regulations issued by the Treasury Department in 1959 brought to a head many administrative and enforcement problems and uncertainties which have plagued both the Government and taxpayers. The difficulty in allowing trade or business expenses generally, but isolating expenses relating to legislative matters and denying deductions for them, stems in part from the difficulty in segregating and classifying such expenses. This is a form of detailed recordkeeping to which taxpayers are not accustomed. Moreover, in the case of many expenses which may primarily be incurred to inform the business itself as to the application of certain proposed legislation, when such information is also made available to legislators it is difficult to determine how an allocation of the expense should be made between legislation and mere planning of the company. Moreover, in the case of an organization, a determination must also be made as to whether the expenses of this type are substantial—a term which involves a difficult determination.

More important than the administrative and enforcement problems, however, are the policy considerations involved in denying expenses with respect to legislative matters. It appears anomalous, for example, that expenses incurred in appearing before legislative bodies or before legislators are not deductible while appearances before executive or administrative officials with respect to administrative matters, or before the courts with respect to judicial matters, are deductible where the expenses otherwise qualify as trade or business expenses. Your committee believes that the present bar on deductions with respect to legislative matters must be modified to place presentations to the legislative branch of government on substantially the same footing in this respect as that with the other two coordinate branches of government.

It also is desirable that taxpayers who have information bearing on the impact of present laws, or proposed legislation, on their trades or businesses not be discouraged in making this information available to the Members of Congress or legislators at other levels of government. The presentation of such information to the legislators is necessary to a proper evaluation on their part of the impact of present or proposed legislation. The deduction of such expenditures on the part of business also is necessary to arrive at a true reflection of their real income for tax purposes. In many cases making sure that legislators are aware of the effect of proposed legislation may be essential to the very existence of a business. The deduction of legislative expenses for those who incur them for personal reasons is not proposed here, since such expenses are not deductible with respect to administrative or judicial presentations and have no bearing on the determination of true taxable income of a business.

B. General explanation of provision

The bill adds a new subsection (sec. 162(e)) to the provision of present law relating to the deduction of trade or business expenses. It provides that certain types of expenses incurred with respect to legislative matters are to be deductible if in all other respects they qualify as trade or business expenses.

The expenses which may be deducted are divided into two categories. The first category relates to expenses in direct connection with appearances, submission of statements or sending of communications. These appearances, statements or communications may be presented either to committees or individual Members of Congress or to committees or individual members of State or local governmental legislatures. The second category of expenses which may be deducted are those in direct connection with the communication of information between the taxpayer and an organization of which he is a member. This communication of information may be either from the organization to the taxpayer or vice versa. In the case of both categories of expenses referred to above, in order for the expense item to be deductible, it must be concerned with legislation or proposed legislation of direct interest to the taxpayer (and to the organization in the latter case). Thus, the expenses may not be in connection with legislative matters such as nominations, etc., but rather must be in connection with specific legislation or proposals for legislation.

The bill also provides that where a taxpayer is a member of an organization and the organization pays or incurs the expenses of the types referred to above on behalf of its members, the dues which the taxpayer pays to the organization in carrying on his trade or business are to be deductible to the extent they are used for such purposes. The remainder of the dues is likely already to be deductible as ordinary and necessary business expenses. Of course, the dues to an organization may be deductible although not all of the organization's legislative activity is connected with each specific member's trade or business. It is sufficient if all of the organization's legislative activity is related to the trade or business of a significant number of the members.

The bill provides two limitations on the deduction of the above-specified expenses for the specified types of legislative activity. It is not intended by your committee that any deduction be allowed for an amount paid or incurred for participation or intervention in any political campaign for any candidate. Of course, this includes participation or intervention in political campaigns in opposition to a candidate as well. Your committee's bill further provides that no expense deduction is to be allowed for expenditures to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums. Thus, no deduction is intended to be allowed for expenses incurred in connection with what is usually called "grassroot" campaigns intended to develop a point of view among the public generally which in turn is directed toward the legislators.

Nothing in this provision is intended to permit the deduction of entertainment expenses. Such amounts, if deductible at all, must meet the tests set forth in the section of the bill explained below, without regard to this provision.

This provision is to be effective with respect to taxable years beginning after December 31, 1962.

V. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES

(Sec. 4 of the bill and sec. 274 of the code)

A. Reasons for provision

The Treasury brought to your committee's attention widespread abuses have developed through the use of the expense account. In his tax message to the Congress last year, the President stated his conviction that entertainment and related expenses, even though having an association with the needs of business, confer substantial tax-free personal benefits on the recipients; and that in many instances deductions are obtained by disguising personal expenses as business expenses. He recommended that the cost of such business entertainment and the maintenance of entertainment facilities be disallowed in full as a tax deduction, and that restrictions be imposed on the deductibility of business gifts and travel expenses.

After full hearings on the proposal and careful consideration of the problem, your committee has concluded that additional restrictions should be imposed on deductions for entertainment and traveling expenses and business gifts. The committee agrees that abuses in this or any other area of the tax law should not be tolerated, but it does not believe that complete disallowance of such expenses, as recommended by the President, is the proper solution to the problem.

Your committee's bill is designed to eliminate the abuses which have developed in this area. The bill provides new rules which, in general, would: (1) disallow a deduction with respect to entertainment activities, except to the extent that the expense is directly related to the active conduct of a trade or business; (2) disallow a deduction with respect to entertainment facilities, unless the facility is used primarily for the furtherance of the taxpayer's trade or business and the expense is directly related to the active conduct of the trade or business; (3) abolish the Cohan rule by requiring the taxpayer to substantiate, by adequate records or by sufficient evidence corroborating his own statement, all expenditures for entertainment and related facilities, and for travel and gifts; and (4) limit the deduction for gifts to \$25 per year per recipient.

The amendments made by this section are to apply to taxable years ending after June 30, 1962, but only with respect to expenditures incurred after that date.

B. General explanation of provision

Your committee's bill adds a new provision to the code (sec. 274), which disallows, in whole, or in part, certain expenses which would be fully deductible under present law. The requirements imposed by this bill are in addition to the requirements for deductibility imposed by other provisions of existing law, which must be met by the taxpayer before this new provision becomes operative. Hence, if an expenditure is claimed under section 162, the taxpayer must first establish that it constitutes an ordinary and necessary expense incurred in carrying on a trade or business, before the provisions of section 274 become applicable.

The only purpose of this section is to disallow deductions in certain cases and therefore this bill does not affect the question of the includi-

bility or excludibility of an item in income of any individual. The rules presently applicable under present law will continue to govern in this respect. Thus, for example, while pins or watches presented to an employee upon his retirement will not be regarded as gifts under this provision, this bill will have no effect in determining whether the recipient of the pin or watch will be taxed on their value.

1. *Disallowance of expenses for entertainment activities.*—The first part of the bill provides that no deduction is to be allowed for any expense with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, except to the extent that the taxpayer establishes that the expense was directly related to the active conduct of his trade or business. Certain exceptions to this rule are provided, however, for expenses not required to meet the new tests. They are discussed in No. 5 below.

Entertaining guests at night clubs, country clubs, theaters, football games, and prizefights, and on hunting, fishing, vacation and similar trips are examples of activities that constitute "entertainment, amusement, and recreation." In addition, "entertainment" includes any business expense incurred in satisfying the personal, living, or family needs of any individual, such as the furnishing of food and beverages, a hotel suite, or an automobile. An objective test will be employed in determining whether an activity is of a type generally considered to constitute entertainment, amusement, or recreation, but the particular business of the taxpayer will be considered in applying this objective test. For example, with respect to a taxpayer who is a professional hunter, a hunting trip would not generally be considered a recreation-type activity. On the other hand, with respect to a taxpayer whose trade or business consists of selling machine tools or manufacturing clothing, a hunting trip generally would be considered a recreation-type activity. Similarly, a theatrical performance would generally be considered an entertainment-type activity, but in the case of a professional theater critic, a theatrical performance would not constitute an entertainment activity.

An objective standard also will overrule arguments such as the one which prevailed in *Sanitary Farms Dairy, Inc.* (25TC 463 (1955)) that a particular item was incurred, not for entertainment, but for advertising purposes. If the activity typically is considered to be entertainment, amusement, or recreation, it will be so treated under this provision. This will be so even where the expense relates to the taxpayer alone.

With respect to expenses for entertainment activities, the bill provides that a deduction will be allowed only to the extent that the taxpayer establishes that the expense was directly related to the active conduct of his trade or business. This means that the taxpayer must show a greater degree of proximate relation between the expenditure and his trade or business than is required under present law. Among other things he will have to show more than a general expectation of deriving some income at some indefinite future time from the making of the entertainment-type expenditure; however, he will not be required to show that income actually resulted from each and every expenditure for which a deduction is claimed.

If the expenditure is for entertainment which occurs under circumstances where there is little or no possibility of conducting business affairs or carrying on negotiations or discussions relating thereto, the

expenditure will generally be considered not to have been directly related to the active conduct of business. Thus, the absence of the taxpayer or his representative from the entertainment activity ordinarily indicates that the entertainment was not directly related to the conduct of the taxpayer's trade or business. Similarly, if the group of persons entertained is large or the distractions substantial, the cost of the entertainment will not be deductible, in the absence of a clear showing of a direct relationship to the active conduct of the trade or business. All the facts and circumstances pertaining to the entertainment activity will be considered in this connection. Thus, expenses incurred for a "hospitality room," at a convention, at which good will is promoted through display or discussion of the taxpayer's products will be treated as so directly related.

Under the bill, deductions for expenditures with respect to entertainment-type activities are limited to the portion of such expense which is directly related to the active conduct of the taxpayer's trade or business; expenses not directly related to the active conduct of business are not deductible. Objective standards will be employed to determine the apportionment between the part of the expense which meets this test and the part which does not. Thus, if a taxpayer entertains a group of 10 individuals, 3 of whom are business customers (with respect to whom this relationship can be established) and 7 of whom are guests (with respect to whom this relationship cannot be established), a deduction will be allowed only for the expenses attributable to the 3 business customers. Since the subjective intent of the taxpayer is not relevant to this determination, it would make no difference that the taxpayer in the above example would not have had the party but for the attendance of the 3 business customers.

Expenses for entertainment, amusement, and recreation should be identified by the taxpayer on his return and treated under the new rules of this bill. It ordinarily will not be appropriate to include these expense items in other categories of business deductions, where their character will not be apparent, such as advertising, public relations, cost of goods sold, reimbursed expenses, etc.

2. Disallowance of expenses for entertainment facilities.—Your committee's bill (sec. 274(a)) also limits the deduction for expenditures incurred with respect to facilities used for entertaining. Under the bill, no deduction is to be allowed with respect to expenses relating to facilities unless the taxpayer establishes (1) that the facility was used primarily for the furtherance of his trade or business and (2) that the expenditure was directly related to the active conduct of his trade or business. In no event can the deduction exceed the portion of the expense which is directly related to the active conduct of the taxpayer's trade or business. Certain exceptions to this rule are provided, however, for expenses not required to meet the new tests. They are discussed in No. 5 below.

The term "facility" includes any item of personal or real property owned or rented by the taxpayer, such as a yacht, hunting lodge, fishing camp, swimming pool, tennis court, bowling alley, automobile, airplane, apartment, hotel suite, home in vacation resort, dining room, and cafeteria. In addition to items commonly regarded as expenses "with respect to a facility," such as expenditures for the maintenance, preservation, or protection of the facility, this provision

also relates to depreciation and losses realized on certain sales of entertainment facilities.

Under the bill, if a facility is used more than one-half for business entertaining, so that more than one-half of the entertainment expense with respect to such facility would be deductible as a business expense under present law, that portion would continue to be deductible to the extent it meets the test of being directly related to the active conduct of the taxpayer's trade or business. If less than one-half of such entertainment expense would be deductible under present law, no deduction would be allowed. Under this provision the facility must actually be used in furtherance of the taxpayer's trade or business; it is not sufficient that the facility is merely "available" for business use. In connection with these determinations, objective rather than subjective standards would be employed.

This rule will prevent tax abuses involving luxury facilities for entertainment, amusement, or recreational purposes. Under this rule a taxpayer who lives in a luxurious apartment and who presently deducts a portion of its rent on the ground that the apartment was used for occasional entertaining of business guests (and thus had a business purpose), no longer will be able to deduct any portion of the rent because the principal purpose of the apartment is personal, rather than business. Moreover, a swimming pool constructed at the taxpayer's residence may not be charged off for tax purposes as an ordinary and necessary business expense unless the taxpayer demonstrates that personal, family, or living purposes were not primarily served by use of the pool.

Club dues and fees paid to any social, athletic or sporting club or organization are treated by the bill as an expense with respect to a facility used for entertainment and therefore will not be deductible where the primary use of the club facilities is personal. If membership entitles the member's entire family to use the facilities of the club, their use will be considered in determining whether business use of the club exceeds personal use. Where the primary use of the club facilities is in furtherance of a trade or business the cost of the club dues or fees will be deductible to the extent of the use directly related to the active conduct of business. Thus, if membership in a club costs \$100 per year and the club is used for such direct business purposes three-fourths of the time, \$75 will be deductible. As in the case of other facilities, it is the actual use of the club which establishes the deductibility of the club dues, not its availability for use, and not the taxpayer's principal purpose for joining the club. However, this does not mean that out of pocket business entertainment expenses incurred at a club will not be deductible where the required direct relationship between the entertainment and the taxpayer's trade or business is shown to exist. Such expenses will be deductible without regard to the tax treatment of club dues.

Club dues for this purpose do not include dues or fees paid for membership in such civic organizations as Kiwanis, Lion's Club, Rotary, Civitan, and similar groups because these organizations are not social, athletic or sporting clubs. Similarly, professional associations such as bar associations and medical associations are not considered social, athletic or sporting clubs. Deductibility of these dues will continue to be governed by the rules of existing law.

3. *Business gifts*.—Under your committee's bill, deduction for business gifts will be disallowed to the extent that the total gifts during the year exceed \$25 with respect to any person. Where gifts are made to the wife of a man who has a business contact with the donor, these gifts are considered as made indirectly by the husband (for purposes of the limitation).

There is the possibility of overlapping application of the entertainment expense and gift provisions in this new section. An item which might be held to be a gift might also be held to be an entertainment expense. For example, tickets to a theater might fall in either category. Since different rules will apply depending upon the category in which the expense item falls, specific regulatory authority is given to the Secretary of the Treasury or his delegate to prescribe, in cases where both provisions would otherwise apply, which provision is to govern. Thus, a "gift" of theater tickets probably would be classified as coming under the entertainment provision, while a book probably would be classified as coming under the gift provision.

4. *Disallowance of expenditures not substantiated*.—Under the bill, taxpayers will be required to substantiate their entertainment and related expenses, their traveling expenses and gift expenses. The bill provides that the taxpayer must substantiate by adequate records or by other sufficient evidence corroborating his own statement the amount of such expense or other item; the time and place of the travel, entertainment, amusement, recreation, or use of the facility, or the date and description of the gift; the business purpose of the expense; and the business relationship to the taxpayer of the person entertained, using the facility, or receiving the gift.

This provision is intended to overrule, with respect to such expenses the so-called *Cohan* rule. In the case of *Cohan v. Commissioner*, 39 F. 2d 540 (C.A. 2d, 1930), it was held that where the evidence indicated that a taxpayer had incurred deductible expenses but their exact amount could not be determined, the court must make "as close an approximation as it can" rather than disallow the deduction entirely. Under your committee's bill, the entertainment, etc., expenses in such a case would be disallowed entirely.

The requirement that the taxpayer's statements be corroborated will insure that no deduction is allowed solely on the basis of his own unsupported, self-serving testimony. However, the degree of corroboration required to support a claimed deduction will vary as respects the business relationship and purpose, the time and place, and the amount of the expense. Thus, oral testimony of the taxpayer, together with circumstantial evidence available, may be considered "sufficient evidence" for the purpose of establishing the business purpose required under the new provision. However, oral testimony of the taxpayer plus more specific evidence would be required to be "sufficient evidence" as to the amount of an expense.

Generally, the substantiation requirements of the bill contemplate more detailed recordkeeping than is common today in business expense diaries. However, a clear, contemporaneously kept diary or account book containing information with respect to the date, amount, nature and business purpose of the expense may constitute an adequate record under this provision.

Your committee does not intend by this substantiation requirement to deny a taxpayer deductions for entertainment, etc., expenses where

he has no records if it can be shown that the failure to produce substantiating records was due to circumstances beyond his control, such as destruction of his records by fire or flood. In such a case, the taxpayer will be permitted to reconstruct the business entertainment, travel, or gift expenses incurred by him in the taxable year.

Under the bill, the Secretary or his delegate may, by regulation, prescribe certain situations in which the substantiation requirements will not be applied. For example, it may be provided that substantiation will not be required for traveling expenses, where such expenses (including the cost of meals and lodging) do not exceed prescribed minimum amounts. This will be of special benefit to employees whose per diem allowance while traveling is within limits established by the Secretary under this provision. Thus, if regulations are issued under which substantiation will not be required for traveling or entertainment expenses where per diem allowances do not exceed 125 percent of per diem allowed a Government employee in the same locality, it would be sufficient evidence for purposes of the substantiation rule to establish only the amount of the allowance and the fact that the business travel occurred.

5. *Exceptions where disallowance provisions will not apply.*—The bill contains nine exceptions to the general disallowance provision described above under heading 1 or 2. Where an expense falls within one of the enumerated exceptions, the item will continue to be deductible to the same extent as allowed by existing law. However, the new substantiation requirements (discussed under heading 4) will have to be satisfied with respect to any such expense. The exceptions are as follows:

(a) Expenses for food and beverages furnished under circumstances which are of a type generally considered to be conducive to a business discussion. The question as to whether the circumstances are conducive to a business discussion are to be tested by such standards as: First, the surroundings in which the meal or beverage was furnished; second, the taxpayer's trade or business or income-producing activity; and third, the relationship to such trade, business, or activity of the persons to whom the food and beverages were furnished.

(b) Expenses for food and beverages (and facilities used in connection with them) furnished on the business premises of the taxpayer primarily for his employees. This is intended to exclude from the disallowance provision facilities such as the company cafeteria or an executives' dining room. This exception would continue to apply even though guests are occasionally served in the cafeteria or dining room.

(c) Goods, services and facilities to the extent that the entertainment, amusement, or recreation (or use of the facility) is treated on the taxpayer's return with respect to the recipient of the entertainment as compensation paid to an employee and from which income tax is withheld. For example, if the taxpayer permitted an employee to use a yacht for a vacation and treated the expenses for its use as compensation paid to the employee for purposes of the withholding tax and for purposes of the taxpayer's tax return, maintenance and crew costs attributable to such use would be deductible in full because of this exception. On the other hand, where a yacht was used exclusively for business enter-

taining the salaries paid to the captain and crew, even though they were treated as compensation and withheld on, would not come within this exception because they are not the recipients of the entertainment.

(d) Expenses paid or incurred by the taxpayer where he pays or incurs the expenses for his employer or a client, customer, etc., and where he is reimbursed by the employer or client, etc. This is designed to prevent the double disallowance of a single expenditure, once to the employee or practitioner, etc., and a second time to the employer or client, etc. This provision will not apply, however, in the case of an employee where the employer treats the amount paid to him as compensation. It also will not apply in the case of a practitioner, etc., unless he accounts to the client, etc., for the expenses incurred. The accounting must represent sufficient substantiation to meet the tests set out under heading No. 4. Thus, if a lawyer enters into a fee arrangement under which his client agrees to reimburse him for expenses (including entertainment expenses) the exception will not apply unless he accounts to his client sufficiently to enable the client to substantiate the expenses as required by the bill.

(e) Expenses incurred for recreation, social, or similar activities (including facilities) primarily for the benefit of employees. The employees referred to in this case are those, other than officers, shareholders, or highly compensated employees. In this case an individual would be considered a shareholder only if he (taking into account holdings of members of his family) holds an interest in the corporation of 10 percent or more. This category is intended to pertain to the usual employee fringe benefit programs, such as expenses of operating a company swimming pool or baseball diamond, as well as the expenses of the annual company picnic or Christmas office party.

(f) Expenses directly related to business meetings of employees or stockholders. While this category will apply to business meetings where some social activities are provided, it is not intended to apply to gatherings which are primarily for social purposes rather than for the transaction of the employer's or company's business.

(g) Expenses directly related and necessary to attendance at a business meeting of any organization, such as a trade association, chamber of commerce, real-estate board, etc., described in section 501(c)(6) of the code.

(h) Expenses for goods, services, and facilities made available to the general public by the taxpayer. This pertains to expenses for the entertainment of the general public by means of television, radio, newspapers, and the like. It also permits deductions for expenses for parks, etc., maintained by companies where the general public may attend. Expenses of distributing samples to the general public would also come within this exception.

(i) Expenses for goods or services (including the use of facilities) which are sold by the taxpayer in a bona fide transaction for an adequate and full consideration in money or money's worth. This exception is designed to insure that a taxpayer who sells entertainment to others will be allowed to deduct expenses of producing that entertainment. Thus salaries paid to employees

of nightclubs and amounts paid to performers other than employees will continue to be deductible by the operator. Moreover, since this type of expense is not considered to be "entertainment" the detailed substantiation requirements prescribed in this bill will not apply.

6. *Interest, taxes, casualty losses.*—The restrictions provided by your committee's bill are not to apply with respect to items which are deductible under specific provisions of law which apply both to business and nonbusiness taxpayers. Thus, deduction for interest paid on a loan to acquire an entertainment facility or property taxes paid with respect to it would continue to be allowed as a deduction, whether or not the entertainment facilities meet the tests of the new provision.

7. *Treatment of entertainment-type facilities.*—Under the bill, if deductions with respect to entertainment-type facilities are disallowed, the disallowed portion is to be treated as an asset which is used for personal, living, and family purposes, rather than as an asset used in the trade or business. Under this provision the basis of such an entertainment-type facility will be adjusted for purposes of computing depreciation deductions and determining gain or loss on the sale of such facility in the same manner as other property (for example, a residence) which is regarded as used partly for business and partly for personal purposes. Thus, if a taxpayer has a yacht which is used three-fourths for direct business entertainment purposes, and he ordinarily would be entitled to \$1,000 for depreciation with respect to the yacht (if it were used entirely for business), \$250 of this amount would be disallowed as a depreciation deduction and would be treated as the basis of an asset not used in the taxpayer's business.

8. *Meals and lodging while in travel status.*—The bill also amends section 162(a)(2) of present law which provides that traveling expenses include "the entire amount expended for meals and lodging." Your committee's bill provides that traveling expenses shall include "a reasonable allowance for amounts expended for meals and lodging." This has been the position taken in Treasury regulations for many years.

9. *Effective date.*—The amendments made by this provision are to apply with respect to taxable years ending after June 30, 1962, but only in respect of periods after that date.

VI. DISTRIBUTIONS IN KIND BY FOREIGN CORPORATIONS

(Sec. 5 of the bill and sec. 301 of the code)

A. *Reasons for provision*

Under present law, when a distribution in kind is made by a corporation to a shareholder which is also a corporation, the amount which is treated as a distribution is the fair market value of the property received or, if lower, the adjusted basis of the property in the hands of the distributing corporation. Where both the distributing corporation and its corporate shareholder are domestic corporations, taking into account the adjusted basis when it is lower than the fair market value of the property may be justified on the grounds that the appreciated property is still owned by a corporation and, in fact, very little has happened. Furthermore, if the distributee corporation sells the property, the same amount of gain will be realized and taxed as if the

distributor corporation had sold it. Where the distributing corporation is a foreign corporation, however, the device of distributing to its U.S. corporate shareholder appreciated property can be used as a device to permit the U.S. corporation to realize on the earnings and profits of the foreign corporation at minimum U.S. tax. Assume, for example, that an American parent has a 100-percent owned foreign subsidiary. This foreign subsidiary has \$100,000 in accumulated earnings and profits resulting from foreign earnings all of which enjoyed complete deferral from U.S. tax. Assume further that the foreign subsidiary is in a position to distribute to its American parent either \$50,000 in cash or a valuable piece of property having a fair market value of \$50,000 but an adjusted basis of only \$20,000. Under existing law, the dividend income to the American parent is \$50,000 if the cash is distributed but is only \$20,000 if the property is distributed. Under the amendment proposed by the bill, however, the dividend income to the parent is the same amount (\$50,000) whether the cash or the property is distributed. This result is believed appropriate since the increase in value of the parent's assets is the same whether it receives the cash or the property.

This is a companion provision to section 16 of this bill. These two provisions taken together are designed to give assurance that when funds are withdrawn from foreign corporations by liquidation of the corporation, sale of the stock or distribution of property in kind that a full U.S. tax is obtained.

B. General explanation of provision

This provision amends existing law (sec. 301(b)(1)(C)) to provide that where there is a distribution in kind from a foreign corporation and the shareholder is a corporation, then the amount of the distribution for dividend purposes is to be the fair market value of the property distributed, and not its adjusted basis in the hands of the distributor where this is lower.

An exception to the rule described above is provided where the distributing corporation, although a foreign corporation, during the 3 years ending with the close of the corporation's taxable year, derived more than 50 percent of its income from sources within the United States. In such cases, to the extent that the income is subject to U.S. tax, the corporation receiving the dividend can continue to apply the rule generally available for domestic corporations. Thus, to the extent the dividend is treated as eligible for the 85-percent dividends received deduction, the amount of distribution will be the adjusted basis of the property to the distributing corporation where this is lower than its fair market value.

The bill also makes appropriate basis adjustments to take into account the changed rules with respect to dividend distributions.

The amendments made by this provision are to apply to distributions made after December 31, 1962.

VII. ALLOCATION OF INCOME BETWEEN RELATED FOREIGN AND DOMESTIC ORGANIZATIONS

(Sec. 6 of the bill and sec. 482 (b) of the code)

A. Reasons for provision

Under present law, foreign corporations which are controlled by domestic corporations or other persons are not taxed by the United States on their foreign source income. Thus, United States imposes no tax with respect to the profits of such a corporation when they are earned although it does impose a tax on the domestic shareholders of this corporation when they receive dividend distributions from it. This taxation at the time of distribution, rather than at the time the income is earned by the foreign corporation, has become known as "tax deferral." U.S. corporations, it is believed may sell goods to their controlled foreign subsidiaries at less than a fair price to avoid a U.S. tax on what should be their full profit for such sales. Similarly, in other cases it is believed that foreign-controlled subsidiaries have sold goods to their domestic parent at more than the fair market price. The effect of such transactions is to understate the taxable income of the domestic corporation subject to U.S. tax and to overstate the income of the foreign subsidiary. Thus, to the extent the U.S. tax rate is above that imposed by the foreign country or country involved, tax deferral is achieved with respect to this diverted income during the period of time the income is held abroad. The Secretary of the Treasury, in his testimony last year on this subject stated:

This is not simply a question of allocating the profits of foreign operations to tax haven countries. It is a problem that significantly affects U.S. taxation of domestic profits. The technique that is used for diverting profits from one company to another among European affiliates is also used to divert income from U.S. companies to foreign affiliates. Income that would normally be taxable by the United States is thrown into tax haven companies with the object of obtaining tax deferral. This is done, for example, by placing in a Swiss or Panamanian corporation the activities of the export division of a U.S. manufacturing enterprise. A very substantial volume of exports is required merely to offset the loss in foreign exchange which the retention abroad of export profits entails.

Present law in section 482 authorizes the Secretary of the Treasury to allocate income between related organizations where he determines this allocation is necessary "in order to prevent evasion of taxes or clearly to reflect the income of any such organizations." This provision appears to give the Secretary the necessary authority to allocate income between a domestic parent and its foreign subsidiary. However, in practice the difficulties in determining a fair price under this provision severely limit the usefulness of this power especially where there are thousands of different transactions engaged in between a domestic company and its foreign subsidiary.

Because of the difficulty in using the present section 482, your committee has added a subsection to this provision authorizing the Secretary of the Treasury or his delegate to allocate income in the

case of sales or purchases between a U.S. corporation and its controlled foreign subsidiary on the basis of the proportion of the assets, compensation of the officers and employees, and advertising, selling and sales promotion expenses attributable to the United States and attributable to the foreign country or countries involved. This will enable the Secretary to make an allocation of the *taxable income* of the group involved (to the extent it is attributable to the sales in question) whereas in the past under the existing section 482 he has attempted only to determine the fair market sales price of the goods in question and build up from this to the taxable income—a process much more difficult and requiring more detailed computations than the allocation rule permitted by this bill.

The bill provides, however, that the allocation referred to will not be used where a fair market price for the product can be determined. It also provides that other factors besides those named can be taken into account. In addition, it provides that entirely different allocation rules may be used where this can be worked out to mutual agreement of the Treasury Department and the taxpayer.

B. General explanation of provision

The bill adds a new subsection (b) to the provision of existing law (sec. 482) authorizing an allocation of income between corporations (or other persons) controlled directly or indirectly by the same interests. The new subsection applies only to sales of tangible property within a group where one of the organizations is domestic and another is foreign (however, there may be more than one domestic or more than one foreign organization involved) but only where the organizations are owned or controlled directly or indirectly by the same interests. In such cases the Secretary of the Treasury or his delegate is authorized (but not required) to allocate the income of the group arising from these sales under the allocation rule described below. Nevertheless, this allocation rule is not to apply where the taxpayer can establish an arm's-length price for the goods in question.

Under the general allocation rule provided by the bill the Secretary or his delegate is to allocate the income between the United States organization and the foreign organization on the basis of the proportion of the assets, the compensation of officers and employees and the advertising, selling and sales promotion expenses of the group which on one hand are not attributable to the United States and which on the other hand are attributable to the United States. For this purpose, only those assets, that compensation and those sales, etc., expenses which are attributable to the property so sold or purchased are to be taken into account.

The allocation need not be based upon the above-mentioned factors alone. The provision specifically authorizes the inclusion of other factors such as special risks, if any, of the market in which the product is sold. In addition, if the taxpayer or the Secretary or his delegate can work out some other mutually agreeable method of allocating income, this alternative method is to be used instead of the rule referred to above.

Generally, the value of the assets to be taken into account in the allocation method is to be the adjusted basis of these assets in the hands of the taxpayer. However, in the case of some foreign corporations, a U.S. concept of adjusted basis for assets may be difficult,

if not impossible, to compute. In such cases, their book values may be used, adjusted to the extent feasible to approximate adjusted basis. The assets to be included in this allocation formula are real property and tangible personal property except inventory and stock in trade. In addition, real property and tangible personal property which are rented are to be taken into account for this purpose.

As indicated previously, the allocation method described above is not to apply to any sale where the taxpayer can establish an arm's-length price. An arm's-length price for this purpose can be established under either of two procedures. First, the taxpayer can determine the arms-length price by establishing the price at which similar or comparable property is sold in the same general marketing areas to unrelated persons either by the taxpayer or by third parties, if the conditions of sale are similar. Second, if the taxpayer cannot determine such a price, nevertheless he may still establish an arm's-length price by taking the price at which similar or comparable property is sold in either the same or other market areas where the marketing conditions or quantities sold may be different. In such cases such a price can be used, but only after adjustment is made for the material differences in area, quantity, or in marketing conditions (including custom duties and transportation costs) and in any other relevant factors. Moreover, these adjustments must be determinable.

The bill provides that the Secretary or his delegate is by regulations to set forth procedures which are similar in principle to those specified above which are to be applied where one of the organizations in the group receives a sales commission, rather than actually receiving title to goods and then selling them. The bill also provides in the case of "sham" or "paper" corporations that no amount is to be allocated to a foreign corporation under this formula if its assets, personnel and office and other facilities outside of the United States are grossly inadequate to provide for its activities outside of the United States.

The bill also provides that the Secretary or his delegate may require the taxpayer to furnish information which may be "reasonably supplied" to the extent this information is needed to apply the allocation rule referred to above which makes use of assets, compensation and selling expenses. Failure to supply this information can lead to the Secretary or his delegate allocating all of the income to the United States.

The bill also provides that where, under the allocation rule set forth in this provision, income is allocated to the domestic corporation which had been subject to foreign income taxes in the hands of the foreign corporation, these foreign taxes, like other expenses related to the income reallocation, are to be attributed to the domestic corporation. Thus, if the domestic corporation is claiming a foreign tax credit, rather than taking a deduction for foreign taxes, a foreign tax credit will be available with respect to this transferred tax as well. However, the income so reallocated for purposes of the overall or per country limit is not to be classified as foreign income.

This provision is to apply with respect to taxable years beginning after December 31, 1962.

VIII. DISTRIBUTIONS OF FOREIGN PERSONAL HOLDING COMPANIES

(Sec. 7 of the bill and secs. 552 and 556 of the code)

A. Reasons for provision

Under present law certain foreign corporations are classified as "foreign personal holding companies" and their income is taxed, on a pro rata basis, to their American shareholders. For a company to be so classified more than 50 percent of its stock must be owned, directly or indirectly, by five or fewer U.S. citizens or residents. In addition, 60 percent, or 50 percent in certain cases, of its gross income must be foreign personal holding company income, that is, must be "passive" types of income, such as dividends, interest, royalties, rents in certain cases, etc.

Elsewhere in this bill (sec. 13) your committee has attributed to U.S. shareholders the passive income of foreign corporations under a much lower income test than the 60 or 50 percent presently applicable to these foreign personal holding companies. In this latter case, where the principal shareholders are likely to be corporations, if from 20 to 80 percent of the gross income of the company is from the specified types of passive income, then the U.S. shareholders are taxed upon their share of this income, or if this passive income exceeds 80 percent of the company's gross income, then the shareholders are taxed on the entire income of the corporation.

In view of the stricter income tests to be made applicable in this latter case, your committee concluded that the foreign personal holding company provisions of present law should be modified to conform.

B. General explanation of provisions

This section makes two modifications in the present foreign personal holding company tax. First, it provides that a company is to be classified as a foreign personal holding company if 20 percent of its gross income is personal holding company income, that is, passive income from dividends, interest, royalties, rents in certain cases, etc. Under present law a corporation initially becomes subject to personal holding company tax only when 60 percent or more of its gross income is derived from the specified types of income. However, once classified as a foreign personal holding company it will remain so if 50 percent or more of its income is derived from these types of income. The 50-percent test will continue to be applied thereafter until there is a year in which the corporation does not have the 50-percent stock-ownership referred to above, or until an elapse of 3 years in which less than 50 percent of its income is from the specified sources. Under the bill the single 20-percent test, applied annually, is to replace this provision.

The second change made in the present foreign personal holding company provisions relates to the definition of "undistributed foreign personal holding company income," namely; the income which on a pro rata basis is attributed to the shareholders. Under present law the undistributed foreign personal holding company income is the entire taxable income with certain modifications (for taxes, charitable contributions, net operating loss deductions, etc.) minus the dividends

paid during the year (and consent dividends). Under your committee's bill this definition of undistributed foreign personal holding company will remain the same in those cases where the specified types of passive income exceed 80 percent of the company's gross income. However, if the foreign personal holding company's passive income represents from 20 to 80 percent of its gross income, then the income to be attributed to the shareholders as undistributed foreign personal holding company income is to be the same proportion of its taxable income (with present law modifications) minus dividends paid (and consent dividends) as its foreign personal holding company income is of its gross income.

These changes are effective with respect to taxable years of the foreign corporations beginning after December 31, 1962.

IX. MUTUAL SAVINGS BANKS, ETC.

(Sec. 8 of bill and secs. 593, 595 and 7701(a) of code)

A. Reasons for provision

Until 1952 mutual savings banks, domestic building and loan associations and certain cooperative banks (hereinafter referred to as mutual savings institutions) were exempt from Federal income tax. This exemption had initially been based upon the premise that the members' money in the case of these institutions was being used for loans to members, or that the institutions were in effect doing business with themselves and that since the earnings of the institutions belonged to the depositors rather than to it, there could be no profit on which to impose an income tax.

In 1951, however, Congress repealed the exemption of these mutual savings institutions and subjected them to the regular corporate income tax. At the same time, however, these institutions were allowed a special deduction for additions to bad-debt reserves which proved to be so large that they have remained virtually tax exempt since 1951. The 1951 legislation provided that additions could be made to a reserve for bad debts in whatever amount the institution deemed appropriate so long as (1) the amount set aside each year did not exceed the income returned by the institution for the year, or (2) its total reserves and surplus did not exceed 12 percent of its deposits or withdrawable accounts at the close of the year.

The President in his tax message of April 20, 1961, observed that—

Some of the most important types of private savings and lending institutions in the country are accorded tax deductible reserve provisions which substantially reduce or eliminate their Federal tax liability.

He further stated that—

These provisions should be reviewed with the aim of insuring nondiscriminatory treatment.

Subsequently, the Treasury Department in its report of July 1, 1961, stated that—

This special bad-debt reserve provision has kept these institutions virtually tax exempt because they may accumulate \$12 tax free for each \$100 of new deposits. During

1960, these institutions had assets of about \$110 billion and they retained on a tax-deductible basis, current earnings of over \$750 million. For 1958, * * * these institutions paid total Federal income taxes of \$8.8 million.

Your committee has reviewed the tax treatment of the mutual savings institutions. It has concluded that the present bad-debt reserve provisions are unduly generous and that they require revision. Accordingly, your committee's bill amends the special bad-debt reserve provisions of existing law which are applicable to these institutions to provide what it believes will be an assurance that significant tax will be paid in most cases on the retained earnings of these institutions. The bill provides reserves consistent with the proper protection of the institution and its policyholders in the light of the peculiar risks of long-term lending on residential real estate which is the principal function of these institutions.

Under the bill, mutual savings institutions will be permitted to add to reserves for bad debts each year whichever of the following amounts is the greatest:

(1) 60 percent of taxable income¹ for the year computed before a bad-debt deduction,

(2) an amount sufficient to bring the balance of the reserve for losses on qualifying real property loans to 3 percent of such loans outstanding at the close of the taxable year, plus an amount sufficient to bring the balance of the reserve for losses on other loans to a reasonable amount, or

(3) if an institution demonstrates a need for a reserve greater than is permissible under (1) or (2), an amount sufficient to bring the overall balance of its reserves to a "reasonable" amount.

Most of these institutions can be expected to use the 60-percent alternative in making additions to their bad-debt reserves. Those who use this method of necessity will be paying tax if they have any taxable income before this deduction. The 3-percent alternative will be primarily beneficial to new or rapidly expanding institutions. These additions to bad-debt reserves provided by the bill should be sufficient to enable these mutual savings institutions to provide adequate returns to depositors and at the same time continue to provide a steady supply of capital to homebuyers of the Nation.

The bill also provides rules governing the tax treatment of mortgage foreclosures by mutual savings institutions. Other important changes include the establishment of a priority for distributions to stockholders in the case of stock savings and loan associations and a change in the definition of "domestic building and loan association." Your committee's bill also repeals the exemptions provided federally chartered savings and loan institutions in the case of the excise taxes on communications and on the transportation of persons.

B. General explanation of provision

1. Additions to reserves for losses on loans.—In the case of mutual savings institutions the bill provides new rules for calculating the deduction allowable for additions to bad-debt reserves, or reserves for losses on loans as they are referred to in the bill. Beginning in 1963, these institutions will maintain two accounts to which additions will

¹ For this purpose, taxable income does not include certain amounts required to be charged to reserves by stock companies.

be made in the future with respect to reserves for bad debts.² One of the two accounts is a reserve for "losses on qualifying real property loans," the additions to which can be determined by the taxpayer under rules set forth in the bill. The other is a reserve for "losses on nonqualifying loans."

Additions to this latter account are required to be "reasonable additions" which means that as in the case of other taxpayers these additions to these reserves will be determined upon the basis of the past experience and other appropriate factors.

In the case of the reserve for losses on qualifying real property loans, the addition to be made each year to this reserve is to be determined by the taxpayer but may not exceed whichever of the following is the largest:

(a) 60 percent of the institution's taxable income for the year computed before this deduction.

(b) the amount necessary to increase the balance in the reserve for losses on qualifying real property loans to 3 percent of such loans outstanding at the close of the taxable year plus a reasonable addition to the reserve for losses on nonqualifying loans;

(c) if the institution demonstrates the need for greater reserves than are permitted under (a) or (b) above, an amount which would be permitted to be added to a reserve for bad debts without regard to the special provision for mutual savings institutions.

Your committee's bill does not impose any overall ceiling on the amount which may be accumulated by a mutual savings institution with respect to its reserve for losses on qualifying real property loans. However, your committee intends from time to time to review the status of this reserve to be sure that the balances maintained in these reserves remain reasonable in light of the overall requirements of the mutual savings institutions.

When losses on loans are realized they will be charged to the appropriate account within the general reserve for bad debts. That is, losses on loans with respect to qualifying real property will be charged to the reserve for such loans and losses on nonqualifying loans will be charged to the reserve for losses on such loans.³

The reserves which are required by the bill to be established—that is, the reserve for losses on qualifying real property loans, the reserve for losses on nonqualifying loans, and the supplemental reserve for losses on loans—are required to be treated as bad debt reserves for all tax purposes (except that no deduction is allowed for any addition to the supplemental reserve). Thus, although these reserves are termed reserves for "loans," they are reserves for bad debts; and any charge to any such reserve for an item other than a bad debt will result in the inclusion in gross income of an amount equal to such charge.

For purposes of determining annual additions to the reserve for losses on qualifying real property loans, mutual savings institutions are to take into account all loans secured by improved real property (whether such loans are insured or uninsured) except Government bonds, certain corporate obligations and certain loans between banks

² They may also have a supplemental reserve which will represent certain reserves built up in the period from 1952 through 1962. This supplemental reserve is explained below.

³ At the election of the taxpayer, losses on any loan instead of being charged to the reserve referred to above may be charged in whole or in part to the supplemental reserve for losses on loans referred to below.

and related parties. Under this provision, both federally insured FHA and guaranteed VA home loans, as well as conventional loans, may be taken into account in determining the amount of additions to the reserve for losses on qualifying real property loans. Loans on improved real property are intended for this purpose to include loans obtained for the construction of improvements on real property, even though at the time the loan is made no improvements may exist on the property.

The following examples illustrate the operation of the alternative choices for additions to reserves for bad debts:

Example 1: At the close of year 10, X building association has improved real property loans outstanding of \$2,000 and nonqualified loans of \$200. Its taxable income before any addition to a reserve for bad debts is \$50. The balance in its reserve for losses on improved real property loans is \$51 and the balance in its reserve for losses on nonqualifying loans is \$1. (Its experience indicates the need for a reserve for losses on nonqualifying loans of 1 percent of such loans, and a reserve for losses on improved real property loans of 2.5 percent of such loans.)

For this year X building association would be permitted to add to its reserves \$30 (60 percent times \$50). (Under the 3-percent method only \$10 could have been added.) Of this amount \$1 would be added to the reserve for losses on nonqualifying loans (making the balance in that account \$2) and \$29 would be added to the reserve for losses on improved real property loans (making the balance in that account \$80). Taxable income for this year would then be \$20.

Example 2: Assume the same facts, except that taxable income before any addition to reserve for bad debts is \$15. X building association would be permitted to add to its reserves \$10. This is the amount necessary to bring the balance of the reserve for losses on nonqualifying loans to \$2 (1 percent times \$200) plus the amount necessary to bring the balance of the reserve for losses on improved real property loans to \$60 (3 percent times \$2,000). (Under the 60-percent method the addition would have been only \$9.) Taxable income would then be \$5 (\$15 minus \$10).

2. *Treatment of pre-1963 reserves.*—At the present time bad-debt reserves etc. of mutual savings banks are about 10 percent of their deposits, while similar reserves of domestic building and loan associations average about 8 percent of deposits. This means that existing reserves of these mutual savings institutions in most cases will exceed 3 percent of improved real property loans, plus a reasonable reserve for other loans.

The bill makes special provision for the treatment of existing bad-debt reserves of mutual savings institutions. If the entire amount of such reserves (called "pre-1963 reserves" in the bill) were required to be allocated to the reserve for losses on qualifying real property loans and to the reserve for losses on nonqualifying loans, the balances of those reserves would in many cases be so large that many mutual savings institutions would be denied a deduction for additions to bad-debt reserves for many years. In order to mitigate this effect, your committee's bill provides that only a portion of such pre-1963 reserves is to be allocated to the reserve for losses on qualifying real

property loans and to the reserve for losses on nonqualifying loans under the following rules:

(a) First there is credited to the reserve for nonqualifying loans whatever portion of these pre-1963 reserves is necessary to bring the balance of this reserve to an amount which would be reasonable on the basis of nonqualifying loans outstanding as of December 31, 1962;

(b) next there is credited to the reserve for losses on qualifying real property loans whatever remaining portion of the pre-1963 reserves is necessary to bring the balance of this reserve up to 3 percent of loans on improved real property outstanding as of December 31, 1962, or to a greater amount if the experience of the institution as of December 31, 1962, indicates a need for a greater reserve; and

(c) finally, any remaining pre-1963 reserves are credited to the supplemental reserve for losses on loans.

Amounts credited to the supplemental reserve for losses on loans can be used only to offset losses on loans (if the institution chooses to charge losses to this reserve). Any other use of this reserve will result in the imposition of income tax.

3. *Distributions to shareholders.*—Some of the savings and loan associations to which this provision is applicable have shares of stock outstanding. Your committee desires to insure that in such cases no amounts are paid to these stockholders until full income tax had been paid with respect to the profits which are distributed to such stockholders; and that the earned surplus which is accumulated under the reserve provisions of the bill should be for the protection of depositors. Therefore, the bill provides that in the case of distributions to the stockholders, the amounts are to be considered as paid out of the following funds of the institution:

(a) first out of the reserve for losses on qualifying real property loans (but only to the extent the balance in such reserve exceeds the amount which would have been allowed the institution in the absence of this special bad-debt provision);

(b) next out of the supplemental reserve for losses on loans;

(c) then out of earnings and profits accumulated in taxable years beginning after December 31, 1951; and

(d) finally, out of other amounts.

Before distributions can be made out of either the reserve for losses on qualifying real property loans or out of the supplemental reserve, income tax must be paid with respect to the amount required to be charged by the stock institution. The amount required to be charged to these reserves and included in income is the amount of the distribution to the stockholder "grossed-up" by the appropriate amount of tax. Only after these reserves (modified as indicated) are exhausted, can distributions be made out of amounts which have already been tax paid. These special rules will insure that the current profit which is allocated to stockholders will pay a regular corporate income tax.

4. *Foreclosures on property securing loans.*—Your committee's bill also adds a new provision to the code containing rules to govern the tax consequences of mortgage foreclosures (or other similar proceedings) in which mutual savings institutions take over property which was security for its loan. Under existing law the foreclosure event is considered a taxable transaction. This has been interpreted to mean

that a bad-debt (or loss) deduction may or may not arise at that time depending upon the bid price for the property. In many instances foreclosed property is bid in for the amount of the loan still outstanding. In such a case present law may not permit a bad-debt deduction to be taken. When the property is subsequently sold by the mutual savings institution, it may simultaneously realize a deductible bad-debt loss and a taxable capital gain.

The bill seeks to avoid these erratic results by providing that in the future a foreclosure is not to be treated as a taxable event, and that amounts received by the mutual savings institution subsequent to the foreclosure are to be treated as payments on the indebtedness. This would be accomplished under the bill by treating the property received in a foreclosure (or other proceeding) as having the same characteristics as the debt for which it was security. Thus, for bad-debt (or loss) purposes the act of foreclosure will not create a taxable occasion; however, if the property has depreciated in value, the decline may be charged against the bad debt reserve as a partially worthless debt. If it continues to decline in value, additional charges may be made against the reserve. When the property is subsequently sold or disposed of, any amount realized is to be treated as ordinary income or loss and is to be charged, or credited, as the case may be, against the primary reserve. Because the foreclosed property is to have the same characteristics as the indebtedness, where property is rented by the mutual thrift institution after foreclosure, no depreciation deduction is to be permitted. However, as explained above, if the property actually depreciates in worth (as contrasted to a mere decline in book value), a charge may be made against the reserves.

5. *Definition of domestic building and loan association.*—Under present law a domestic building and loan association is defined as a—

domestic building and loan association, a domestic savings and loan association, and a Federal savings and loan association, substantially all of the business of which is confined to making loans to members.

Problems have arisen with this definition because loans in many cases now are in substance not loans made to members. It is understood that technical conformance has been maintained with the membership requirement of present law by making borrowers of funds members of the institutions. However, questions have arisen as to the substance of such provisions.

As a result, your committee has concluded that the definition of a domestic building and loan association, eligible for the tax treatment described above, should be brought more nearly into conformance with actual practice. At the same time it was deemed desirable to restrict this tax treatment to those primarily engaged in making residential real estate loans and omitting from the definition cases such as those where these institutions have been used for speculative purposes.

In view of these considerations, your committee has redefined a domestic building and loan association to mean a building or savings and loan association which is an insured institution within the meaning of section 401(a) of the National Housing Act or one which is subject by law to supervision and examination by State or Federal authority having supervision over such associations. In addition, however,

the bill provides that an institution in either of these groups qualifies only if substantially all of its business consists of accepting savings and investing the proceeds in—

(a) loans secured by an interest in residential real property (or property which after application of the loan is to become such property), and

(b) other loans to the extent they would be authorized to be made by a Federal savings and loan association under the second paragraph of section 5(c) of the Home Owners' Loan Act.

The types of loans referred to in the second paragraph of section 5(c) of the Home Owners' Loan Act include home-improvement loans whether or not secured by real property.

6. *Repeal of certain excise tax exemptions.*—Under present law, Federal savings and loan associations are exempt from the excise taxes on communications and the excise tax on transportation of persons. These exemptions were granted by the Home Owners' Loan Act of 1933. No other mutual savings institution is entitled to exemption from these taxes. Your committee believes that the continuation of these exemptions is no longer desirable. Accordingly, the bill repeals these exemptions effective as of June 30, 1962.

7. *Effective date.*—The new rules provided by the bill for additions to reserves for bad debts are to apply to taxable years ending after December 31, 1962. However, the bill provides a special rule to deal with fiscal years where a taxpayer has a year which begins in 1962 and ends in 1963. The effect of this special rule is to continue the rules under existing law up to the end of December 1962, and to apply the new rules as of January 1, 1963.

The tax treatment provided for property acquired in mortgage foreclosure proceedings is to apply to transactions occurring after December 31, 1962, in taxable years ending after that date. The repeal of the exemptions from excise taxes on communications and on transportation of persons is made effective as of June 30, 1962.

X. DISTRIBUTIONS BY FOREIGN TRUSTS

(Sec. 9 of bill and secs. 643, 665, 666, 668, 669, 6047, 6677 and 7701 of code)

A. *Reasons for provision*

The Secretary of the Treasury in his appearance last year before your committee called attention to the manner in which some individuals establishing foreign accumulation trusts are avoiding U.S. tax. The avoidance device involves the setting up of a trust for the benefit of U.S. beneficiaries by a U.S. grantor or settlor in a foreign country where such trusts are subject to little or no taxation. U.S. tax on the trust income is avoided in such cases if the trust property consists of foreign securities which result in foreign source income not subject to taxation by the United States. The trust income is then accumulated tax-free in the trust (except for foreign tax, if any) for any number of years, and then the trust is finally terminated with the corpus and income being paid to U.S. citizens or residents. In such cases the trust income may be subject to a small tax or no tax at all in the hands of the U.S. beneficiaries, depending upon the circumstances.

Under present law, domestic trusts accumulating income are taxable on such income currently at the same rates applicable to individuals. When the accumulated income is distributed to beneficiaries, the distribution may then be taxable to the beneficiaries to the extent it represents income accumulated during the 5 immediately preceding years. Although the tax is payable currently in such cases, it is computed as if the beneficiary received a distribution of this income in each of these prior years in which the income was earned, with a credit being allowed for the taxes paid by the trust with respect to this income.

This rule, known as the "5-year throwback rule" presently may apply when a foreign trust makes distributions to U.S. beneficiaries. In any case, however, it does not apply to any income accumulated for more than 5 years. In addition, there are a number of exceptions making distributions nontaxable to the beneficiaries even where they are attributable to the 5 immediately preceding years. For example, the 5-year throwback rule does not apply to accumulations to be distributed to a beneficiary upon reaching age 21; to a beneficiary to meet emergency needs; to a beneficiary upon reaching a specified age if not more than four such distributions can be made or the distributions are at least 4 years apart; and to a beneficiary where a trust terminates and makes a final distribution which occurs more than 9 years after the date of the last transfer to the trust. As a result of these exceptions, and the 5-year limitation, it is relatively easy for U.S. grantors or settlors to establish foreign trusts which pay little or no tax on trust income and which upon termination make distributions to American beneficiaries who pay little or no U.S. tax.

In the last Congress, a bill (H.R. 9662) which was passed by the House, but on which action was not completed by the Senate, contained an amendment added by the Senate Finance Committee designed to discourage the creation of foreign trusts for the purpose of avoiding U.S. tax. In addition, the Secretary of the Treasury in his testimony before your committee last year recommended that with respect to existing trusts the law be modified so that distributions to a U.S. beneficiary from a foreign trust would be subject to tax in the year of distribution in an amount equal to the tax which would have been imposed had the income been distributed currently. As indicated by the Secretary in his testimony, this is in effect an extension of the existing 5-year throwback rule.

In view of the existing avoidance possibilities with respect to these foreign trusts, your committee's bill, as recommended by the Secretary of the Treasury, taxes American beneficiaries of foreign trusts created by U.S. grantors, settlors or transferrors in substantially the same manner as if the income had been distributed to the beneficiary currently as earned (although a "shortcut" method of computation may be elected by the taxpayer in place of this more "exact" method). This provision is not viewed by your committee as imposing a penalty but rather as a method for treating U.S. beneficiaries of foreign accumulation trusts created by, or added to, by Americans in substantially the same tax status as the beneficiaries of domestic trusts distributing their income currently.

B. General explanation of provision

The new provision applies to foreign trusts to which money or property has been transferred, directly or indirectly, by U.S. persons or under the will of a decedent who was a U.S. citizen or resident. A foreign trust for this purpose is one the income of which from sources without the United States is not includible in gross income for U.S. tax purposes. U.S. persons as used here include U.S. citizens or residents, domestic partnerships and corporations, and estates and trusts.

In the case of these foreign trusts, any of their accumulated income, other than income distributable currently, upon distribution to a U.S. citizen or resident is to be taxed to him. The amounts distributed to the U.S. beneficiary are treated as if they had been distributed in the preceding years in which income was accumulated, but are includible in income of the beneficiary for the current year. However, under the bill the tax on such amounts may be computed, at the election of the beneficiary, in either of two ways. One method, referred to here as the "exact" method, is substantially the same as the method provided under present law in the case of distributions subject to the "5-year throwback rule." In addition, however, the bill provides a "shortcut" method which the beneficiary may elect if he does not desire to go through the more extensive computations required by the exact method.

Under the exact method of computation, the tax on the amounts distributed cannot exceed the aggregate of the taxes that would have been payable if the distributions had actually been made in the prior years. This method requires complete trust and beneficiary records for all past years, so that the distributable net income of the trust can be determined for each year, as well as the years in which trust income was accumulated. The beneficiary's own tax then is recomputed for these years, including in his income the appropriate amount of trust income for each of the years (including his share of any tax paid by the trust). Against the additional tax computed in this manner the beneficiary is allowed a credit for his share of the taxes paid by the trust, including a foreign tax credit for income taxes paid foreign countries. Any remaining tax then is due and payable as a part of the tax for the current year in which the distribution was received.

The so-called short-cut method in effect averages the tax attributable to the distribution over a number of years, equal to the number in which the income was earned by the trust. This is accomplished by including, for purposes of tentative computations, a fraction of the income received from the trust in the beneficiary's income for the current year and each of the 2 prior years.¹ The fraction of the income included in each of these years is the same as the number of years in which the income was accumulated by the trust. Thus if the accumulated income is attributable to 10 different years (although the trust may have been in existence over longer than a 10-year period, however), then one-tenth of the amount distributed would be included in the income of the current year and one-tenth in each of the 2 prior years. The additional tax is then computed with respect to these 3 years and the average additional tax for the 3 years deter-

¹ The 2 prior years are included for this purpose only to prevent the current year, in which there may be special circumstances, from having too great an influence on the averaging device used.

mined. This average is then multiplied by the number of years to which the trust income relates, namely, 10 in the example used here. The tax so computed may be offset by a foreign tax credit for any foreign taxes paid by the trust and any remaining tax liability is due and payable in the same year as the tax on the beneficiary's other income in the year of the distribution.

The bill provides certain exceptions from the two computation methods outlined above. First, if short-cut method is used and the number of trust years to which the income relates is less than three, then the average is determined on the basis of any smaller number of years to which the distribution actually related. Second, if the beneficiary was not yet born, with respect to a year to which part of the trust income which is distributed relates, the so-called exact method of computation is not to be used. Similarly, where the beneficiary was not yet alive for the full 3-year period in which the shortcut averaging device is applied, then this averaging device is to be computed on the basis of the shorter period in which the beneficiary was in existence. Third, the bill specifies how prior distributions from foreign trusts to the beneficiary are to be treated in making these computations. Where a taxpayer with respect to an earlier distribution has used the shortcut method and subsequently uses the exact method for another distribution, he is to include in his income for purposes of this exact computation, any income received from the trust in the earlier distribution must be included in his income for any year to which the second distribution relates, to the extent attributable to the years in question. However, where in the current distribution the taxpayer is using the so-called "shortcut" method, he is not required to take into account prior distributions from a foreign trust, whether the exact or shortcut method of taxation was used in the prior computations.

As under present law, the methods of tax computation outlined above are substitutes for including and taxing the entire amount of the distribution in the year actually received. To take advantage of either method the beneficiary at the time of making the election must supply such information with respect to the operation and accounts of the trust for each of the years in which an amount is considered distributed as the Secretary or his delegate may by regulation prescribe. This information is necessary in order to give assurance that the computation is made correctly.

So that the Internal Revenue Service will be aware of the existence of foreign trusts created by American grantors, settlors or transferors, the bill provides that the grantor of an inter vivos trust or the fiduciary of an estate in the case of a testamentary trust, or the transferor is to make a return within 90 days after the creation of the foreign trust or the transfer of money or property to it by an American person, setting forth such information with respect to the foreign trust as the Secretary or his delegate prescribes by regulation as necessary to carry out the provisions of the income tax laws. Failure to supply the information, unless it can be shown that this failure is due to reasonable cause, under the bill is to result in a civil penalty (in addition to any criminal penalty presently provided by law) equal to 5 percent of the amount transferred to the trust but not to exceed \$1,000. A similar penalty applies with respect to a return which does not show the information required, even though the return itself is filed.

Generally, these provisions relating to foreign trusts are to apply to distributions made in taxable years of the trust beginning after the date of enactment of this bill. The provisions relating to returns with respect to the creation of, or transfers to, a foreign trust, the civil penalties relating to these returns, and the definitions of U.S. persons and foreign estates and trusts added to the bill, are to be effective on the date of enactment of the bill.

XI. MUTUAL FIRE AND CASUALTY INSURANCE COMPANIES, ETC.

(Sec. 10 of the bill and secs. 821-825, 831, and 832 of code)

A. Reasons for provision

Stock fire and casualty insurance companies have long been taxed at ordinary corporate income tax rates on both investment income and underwriting income. Mutual fire and casualty insurance companies, on the other hand, since 1941 have paid tax under special formulas which do not take into account their underwriting income or loss. Generally, these mutual companies presently are taxed under whichever of two formulas results in the higher tax. Under one formula, they are taxed at ordinary corporate income tax rates on investment income only. Under the other, they pay a tax of 1 percent on their gross investment income plus their premium income after policyholder dividends. Reciprocal underwriters and interinsurers are taxed only on their investment income and they have a vanishing \$50,000 exemption. Mutual companies with total receipts of not more than \$75,000 are tax exempt.

The President recommended that stock and mutual fire and casualty insurance companies be taxed on the same basis. He proposed that mutual companies pay tax on their underwriting profits, as well as on their investment income, substantially in the same manner as stock companies.

Your committee's bill to a considerable degree achieves the result sought by the President. Under it, mutual fire and casualty insurance companies are taxed under a modified total income formula. The modifications are required because of the special circumstances of the mutual companies.

While a stock insurance company can pay extraordinary losses not only out of its accumulated profits but out of its paid-in capital, a mutual insurance company can pay extraordinary losses only out of retained underwriting income. As a result, a mutual ordinarily retains a portion of its underwriting income each year for this purpose; the remainder is paid to its policyholders as policy dividends. This accumulated underwriting income constitutes its reserve out of which insurance losses can be paid, and the existence of such reserves is an important protection to the mutual policyholders.

Under the law up to this time, no income taxes have been paid on this retained underwriting income, except (since 1941) to the extent the excess of the alternative 1-percent tax over the tax on investment income in effect taxed part (all, or more than all) of the underwriting income. Similarly underwriting losses may not reduce the tax on investment income. Under the President's proposal, underwriting gains would have been fully taxed as realized. Under the provisions

of your committee's bill, however, these mutual fire and casualty companies will be permitted to set aside a portion of each year's underwriting gain in a special account for protection against losses. This amount will be available to meet certain losses for 5 years, after which, most of any remaining portion will be included in taxable income of the sixth year. A small portion, however, will still be retained in the special account to take care of extraordinary losses. Eventually, these companies will pay tax on their total income, but the tax deferral formula of the bill gives recognition to the mutuals' lack of access to the capital market for funds with which to pay losses. Under the committee bill underwriting losses, in excess of gains, will reduce the tax on investment income.

Under the provisions of your committee's bill mutual companies which have substantial underwriting gains will pay larger taxes than under present law. However, the full impact of taxing their underwriting income will be delayed until 1968. Thus, for a 5-year period only a portion of underwriting income of the mutual fire and casualty industry will be exposed to the Federal income tax. Thereafter, most of the amounts in the account which are not used for the payment of losses within 5 years will be taxed, but this will be offset—or more than offset if the company is growing and its underwriting income is increasing—by the portion of the income of the sixth and subsequent years which is set aside in the protection against loss account.

On the other hand, mutual fire and casualty companies having underwriting losses will, for the first time, be permitted to deduct these losses in full. For such companies the tax under your committee's provisions will be less than under present law which taxes the investment income of a mutual company at full corporate rates even though there is an underwriting loss. On the other hand, a stock company is taxed only on the net amount after deducting an underwriting loss against investment income. Your committee believes that this inequality of treatment should not continue. Under this bill an underwriting loss would be offset against the protection against loss account (or investment income), and any loss not so absorbed would be carried back (though not to a year before 1963) or carried forward, as in the case of corporations generally.

Some mutual insurance companies specialize in insurance against limited risks such as windstorm, hail, or flood, in relatively small geographical areas. Because their operations cover a small area, few storms or floods may occur in some years and the company will then have relatively large underwriting gains; in other years, storms may cause heavy damage in the area of operations and the company will have relatively large underwriting losses. To compensate for this uneven experience your committee's bill permits these concentrated risk companies to defer, in the protection against loss account, a greater proportion of underwriting income than is permitted for ordinary companies. This is to protect them against unusually large losses if, and when, such losses occur.

Your committee's bill does not affect the tax status of very small mutual companies; that is, companies whose total receipts from all sources do not exceed \$75,000. Such companies will continue to be exempt from Federal income tax. Companies with total receipts between \$75,000 and \$300,000 also will be treated much as they are

under existing law; i.e., these companies will pay tax on their investment income only (however, the alternative 1-percent tax of present law will no longer apply). Your committee believes this treatment is justified because these small companies often are of the assessment type and are not required to compute and report their underwriting income on approved forms for State insurance commission purposes. Your committee's bill makes it unnecessary for them to compute their underwriting income in the future. Small companies with total receipts between \$300,000 and \$900,000 will be taxed both on their investment income and on their underwriting income. However, to provide for a gradual transition to the new tax on their underwriting income, the bill provides a special deduction of \$6,000 which decreases as total receipts of the company increase above \$300,000. This means that at \$900,000 there is no special deduction.

Reciprocal underwriters and interinsurers differ from ordinary mutual insurance companies in that their business is conducted by two entities rather than one. An ordinary mutual insurance company receives all of the premium income from insurance and not only pays losses but conducts directly the operation and management of the insurance activities. The reciprocal underwriter or interinsurer, on the other hand, pays its insurance losses, but an "attorney-in-fact" performs all, or most, of the insurance functions—writing policies, collecting premiums, settling claims, keeping records, etc.—and pays the related expenses, for a portion of the premium income of the reciprocal. Profits realized by the attorney-in-fact from conducting these insurance operations are taxed as ordinary income. However, if that income were earned by a mutual insurance company which performed these operations itself, under existing law it would constitute underwriting income and would not be taxed. Moreover, under present law reciprocal underwriters and interinsurers are not taxed in the same way as ordinary mutuals since they are not subject to the alternative 1-percent tax and have a special exemption. Your committee's bill taxes reciprocal and interinsurers under the same rules that apply to ordinary mutuals; but in recognition of their unique form of operation it permits them in effect to combine the underwriting income of the attorney-in-fact with their own for certain purposes.

Under present law, factory mutual insurance companies are taxed under the same formulas as other mutuals, that is, they pay tax on investment income only (with no deduction for underwriting losses) or under the alternative 1-percent formula. However, because of the very large premium deposits required of their policyholders (typically up to 10 times the amount of an ordinary premium) the investment income of such companies is very large. As a result in practice they never become subject to the alternative 1-percent tax. As in the case of other mutuals, these companies are not permitted to deduct their underwriting losses. This has been a handicap to these companies in years in which they have losses, because the industrial risks which they insure generally are quite large. Your committee's bill taxes factory mutual companies as if they were stock companies, thus permitting them to deduct underwriting losses when they occur. However, since a large portion of each premium is in effect a deposit (which may be returned to the policyholder), in computing their underwriting

profits these companies are to be permitted to determine their premium income on the basis of their schedules of absorbed premium deposits. The amount so determined will be increased by 2 percent for income tax purposes to offset the advantage of the temporary use of deposits which would ordinarily be viewed as premiums received.

B. General explanation of provision

Under present law the tax on a mutual fire and casualty insurance company is, in general, the greater of (1) a tax at the ordinary corporation rates on the company's net income from investments, or (2) a tax of 1 percent of its gross income from both investments and premiums less dividends to policyholders. Under the new provisions the 1-percent alternative tax is eliminated, and the tax is computed at the ordinary corporation rates on the company's total income (investment income and underwriting income) less amounts temporarily set aside in a protection against loss account. Underwriting income of these insurance companies is the excess of premiums received over insurance losses and expenses incurred and dividends paid to policyholders.

There are special provisions for companies with concentrated risks, for small companies, and for reciprocals or interinsurers. Your committee's bill also removes the factory mutuals from the treatment accorded mutual casualty companies generally, and treats them as if they were stock companies, with special provisions for determining what portion of their premium deposits is to be viewed as earned premiums.

1. Ordinary mutual fire and casualty insurance companies.—Under the bill taxable income of mutual insurance companies will consist of taxable investment income, statutory underwriting income, and, certain amounts previously set aside for protection against losses. Statutory underwriting income as used in the bill is underwriting income after a special deduction for protection against losses of an amount equal to 1 percent of insurance losses incurred during the year and 25 percent of the ordinary underwriting income.

An amount equal to the special deduction is to be set aside for 5 years in a "protection against loss" account where it can be used only for offsetting losses. At the end of the fifth year, if the amount credited to the protection against loss account has not been absorbed by losses, the portion attributable to the 1 percent of losses and one-half of the portion attributable to the 25 percent of underwriting income will be withdrawn from the account and included in taxable income for that fifth year. The other one-half of the amount representing the 25 percent of underwriting income is retained in the account for a longer period as a cushion against extraordinary losses.

The bill limits the amount which may be accumulated in this account, however. The amount in this account may not be increased above an amount which at the end of any year is more than 10 percent of the earned premiums less dividends to policyholders for that year. If a greater amount were already in the account at the beginning of the year, the account would not be reduced (because of the ceiling) below this amount.

If in any year there is a loss from underwriting loss instead of a gain, the part of the loss resulting from the payment of insurance claims and expenses would be offset directly against taxable investment income. Any amount not so offset and other losses (those resulting from the payment of policyholder dividends or from the special protection against loss deduction) would be charged against the protection against loss account on a first-in, first-out basis. Losses charged against the account would be applied proportionately to amounts representing the 1 percent of losses incurred and the 25 percent of underwriting income.

If in any year there is an extraordinary underwriting loss—more than the investment income for that year and the entire amount in the protection against loss account—the excess will be treated as an ordinary net operating loss, to be carried back against the taxable income of the 3 preceding years or carried forward (first against amounts added to the protection against loss account and then against otherwise taxable income) to the succeeding 5 years, as in the case with any corporation.

In computing their taxable income, mutual companies are to be allowed an unlimited deduction for dividends paid to policyholders.

Under present law mutual insurance companies which are not subject to the 1-percent alternative tax are allowed a special exemption of \$3,000, with the tax on taxable incomes between \$3,000 and \$6,000 gradually increasing until the exemption completely vanishes when taxable income reaches \$6,000. The bill increases this special exemption (applicable to the new total of investment and underwriting income) to \$6,000 in the case of mutual companies taxable under the general rules of the bill. There also is a gradually increasing tax on taxable incomes between \$6,000 and \$12,000, so the exemption vanishes when taxable income reaches \$12,000.

2. *Example.*—The computation of taxable income, statutory underwriting gain and the protection against loss account for a 6-year period with successive underwriting gains, may be illustrated as follows, assuming the simplified facts as shown in the following table:

Year	Taxable investment income	Underwriting income	Insurance losses incurred	Additions to protection against loss account
1963.....	\$10	\$12	\$700	\$7+\$3 (\$10)
1964.....	11	16	800	8+ 4 (12)
1965.....	12	12	600	6+ 3 (9)
1966.....	13	20	600	6+ 5 (11)
1967.....	14	24	900	9+ 6 (15)
1968.....	15	20	1,000	10+ 5 (15)

For 1963 the statutory underwriting income would be \$2, the underwriting income of \$12 minus the 1 percent of incurred losses (\$7) and the 25 percent of the underwriting income (\$3) credited to the protection against loss account. The taxable income would be \$12, the sum of the taxable investment income and the statutory underwriting income. For 1964 the statutory underwriting income would be \$4 and the taxable income \$15; for 1965 corresponding figures would be \$3 and \$15; for 1966, \$9 and \$22; and for 1967, \$9 and \$23.

For 1968 the statutory underwriting income would be \$5 (\$20 minus \$10 minus \$5), but there would be included in taxable income an amount equal to the first item added to the protection against loss account in 1963 (\$7), and half of the second item (\$1.5), so that for 1968 the taxable income would be \$28.5, the sum of the taxable investment income (\$15), the statutory underwriting income (\$5), and the \$8.5 withdrawn from the protection against loss account.

At the end of 1968, therefore, the total amount in the protection against loss account would be \$63.5—amounts added for 1964 and the 4 following years, available to offset losses occurring during the next 5 years, and a residual \$1.5 to offset any loss which exceeded the entire amount in the account other than that.

If, in the preceding example, for 1966 there had been an underwriting loss excluding policy dividends and the protection against loss deduction of \$11, a loss after dividends of \$30, and insurance losses incurred had still been \$600 the deduction added to the protection against loss account would thus have been 1 percent of \$600 or \$6 and the statutory underwriting loss would be \$36. In that case the portion of the loss not resulting from policy dividends and the protection against loss deduction (\$11) would be offset against the taxable investment income of \$13, the taxable income for 1966 thus being \$2. The remaining portion of the loss (\$25) would be charged against the protection against loss account, the \$10 added to that account in 1963 and the \$12 added in 1964 being eliminated, and of the 1965 addition there would remain \$4 and \$2. In that case there would be nothing from the protection against loss account to be included in taxable income for 1968 or 1969.

3. *Casualty companies with concentrated windstorm, etc., risks.*—As stated above, most mutual insurance companies will report and pay a tax currently on the underwriting income remaining after transferring to the protection against loss account 25 percent of underwriting income plus 1 percent of incurred losses. With respect to certain insurance companies whose risks from losses from windstorm, hail, flood, earthquake, or similar hazard, are concentrated in one State, however, your committee's bill permits deferral of more than 25 percent of underwriting income. The percentage of underwriting income which can be credited to the account in their case is determined by dividing the premiums earned on insurance contracts attributable to one State (relating to losses from windstorm, hail, flood, earthquake, or similar hazard) by total premiums earned by the insurance company. If this does not exceed 50 percent, the regular rule is used. If it does, the normal deduction of 25 percent of underwriting income is increased by the excess of that percentage over 50 percent. Thus, under this rule, a company which has 90 percent of its windstorm, etc. risks insured in one State would be permitted to transfer 65 percent (the regular 25 percent plus 40 percent) of its underwriting income to the protection against loss account. However, concentration of risks in one State will not serve to permit a larger percentage of incurred losses to be credited to the protection against loss account.

The overall limitation on the protection against loss account of 10 percent of premiums less policy dividends for the year is not to apply to the amount of underwriting income in excess of 25 percent which these concentrated risk companies add to their protection against loss account. If it did apply it would defeat the objective of allowing a

greater portion of underwriting income to be set aside. In applying the ceiling and also in determining the amount which is to be retained in the account after 5 years, the concentrated risk company is to be treated as if it had transferred only 25 percent of its underwriting income to the account.

4. *Small companies.*—Under the bill, small mutual fire and casualty insurance companies (those whose total receipts—gross investment income, excluding capital gains, plus premiums—exceed \$75,000 but do not exceed \$300,000) are not taxed on underwriting income. As under present law, these companies will continue to pay tax on investment income only (with no deduction for underwriting losses) but the alternative 1-percent tax will no longer apply. The special exemption of \$3,000, with the “notch” rates applying to taxable incomes between \$3,000 and \$6,000, also will continue in effect.

Despite the general rule described above, the bill permits these small companies to elect to be taxed on total income, including underwriting income, in the same manner as other mutual companies, and such an electing company will similarly be allowed to deduct underwriting losses. Presumably the existence, or expectation, of underwriting losses would be the primary reason for making this election. The election, once made, cannot be changed without the consent of the Treasury Department. On the other hand, a small mutual company which becomes taxable under the general rules because its gross investment income plus premiums exceed \$300,000 in a taxable year, again will be taxed as a small company if its income falls below this level, if one condition is met. If while it was taxed under the regular formula it was required to credit a portion of its underwriting income to the protection against loss account, this amount must be taken into income and a tax paid on it before the small company treatment will again apply. To provide consistent tax treatment for these small companies, the bill does not permit loss carrybacks or carryovers to be carried to, from or over a year in which the company was taxable as a small company.

In the case of mutual fire or casualty insurance companies whose total receipts are between \$300,000 and \$900,000, your committee's bill provides a special vanishing deduction which is to apply to underwriting income only. For a company whose total receipts are just above \$300,000, the special deduction will be almost \$6,000. As total receipts increase, the \$6,000 deduction decreases and finally vanishes when total receipts of the company equal \$900,000.

5. *Reciprocal underwriters and interinsurers.*—Under your committee's bill, reciprocal underwriters and interinsurers are in general taxed in the same way as ordinary mutuals, with two important exceptions.

First, reciprocal underwriters and interinsurers may elect to take into account the income of the attorney-in-fact which is attributable to the insurance business of the reciprocal. It accomplishes this by not deducting that part of the fee paid to the attorney-in-fact which is equivalent to the attorney-in-fact's profit from the insurance operation. This election may be made, however, only if the attorney-in-fact is a corporation which keeps its records on the same basis as the reciprocal and certain other requirements are met.

An election by a reciprocal is never to reduce income taxes of the attorney-in-fact. The attorney-in-fact will continue to determine

its tax just as it does under present law except that it must identify income and expense items attributable to the insurance business of the reciprocal.

An electing reciprocal will compute its tax liability on the combined income by applying the formula of this bill to the combined underwriting income, except that 25 percent of underwriting income transferred to the protection against loss account is to be measured by the underwriting income of the exchange only. As an offset to the increased tax due to the inclusion of the income of the attorney-in-fact, the reciprocal may take tax credit for the tax paid by the attorney-in-fact to the extent relating to its income from insurance operations. (Under certain circumstances this may result in a refund to the reciprocal.)

If the combined underwriting account of the reciprocal and its attorney-in-fact shows a loss the ordinary rules of the bill for changing it are to apply. Thus, the loss would be charged first to investment income if it is from the payment of claims or expenses, or to the loss protective account of the reciprocal if it is a loss created by payment of dividends or by the special loss protection deduction.

The inclusion by the reciprocal of the insurance income of the attorney-in-fact can benefit the reciprocal in those cases where the deduction for 1 percent of insurance losses would otherwise exceed the underwriting income, by permitting a larger deferral of tax than would otherwise occur.

The second special feature of the bill relating to reciprocal underwriters or interinsurers permits them to deduct savings credited to individual subscribers' accounts (in the same manner as policyholder dividends paid in cash) if the company would be obligated to pay those amounts promptly to the subscriber if he terminates his contract. This is provided because the "pure," or "classical," reciprocal or interinsurer typically credits the account of each policyholder with savings attributable to his contract and because the policyholder has a legal right to receive the amount so credited if he withdraws from the exchange. Because amounts credited to the account of an individual subscriber represent reductions to him in the cost of insurance, the bill provides that for income tax purposes the subscriber must reflect this reduction when the credit is made. The bill in effect requires the business policyholder of a reciprocal to take into account for purposes of computing his income for insurance costs by the amount credited to his account by the reciprocal.

This deduction for credited savings, as stated above, is to be available only in case of so-called "pure" or "classical" reciprocals or interinsurers where the credits, as a matter of actual practice, are paid to policyholder subscribers who terminate their contracts. An ordinary reciprocal which may nominally meet the requirement of the statute would not be entitled to this deduction where savings credited to subscribers are not in fact returned to them when they terminate their policies.

6. *Factory mutual insurance companies.*—The bill amends the law with respect to factory mutual insurance companies in two important respects. First, commencing in 1963, these companies will be treated for tax purposes as if they were stock companies. This means that they will report their underwriting income in full in the year earned, and their underwriting losses after 1962 will be deductible in full.

Secondly, the method of computing premium income of factory mutuals is modified to conform more closely to the actual operation of these companies. This is accomplished by permitting them to determine their premium income on the basis of their schedule of absorbed premium deposits. The amount thus determined is then to be increased under the bill by 2 percent of absorbed premiums for income tax purposes. For example, a factory mutual might require a premium deposit of \$1,000 and its experience indicates it will absorb 12 percent of the premium deposit each year during the term of the policy. Under existing law, in the case of a 3-year policy, the factory mutual would realize earned premiums of \$333.33 each year (one-third of the premium deposit) and would deduct returns to policyholders as if they were dividends. Actually, however, the factory mutual absorbs only 12 percent of the premium deposit, or \$120 each year. Under the bill, this factory mutual will report for income tax purposes \$122.40. This bill also provides for an adjustment in the unearned premium account of the factory mutual for returns of unabsorbed premium deposits to policyholders upon termination of their policies. This return of unabsorbed premium deposit is viewed as analogous to a dividend or a payment similar to a dividend.

7. *Mutual marine insurance companies.*—Mutual marine insurance companies have been taxed as stock insurance companies for many years and your committee's bill continues this treatment for them. However, a question has arisen as to whether a company which was a mutual marine insurance company under prior law is still to be treated as such a company if it engages in substantial multiple line underwriting. In order to clarify the law for the future, your committee's bill provides that any mutual marine insurance company which was taxed as a stock company for a period of at least 5 years may elect to continue to be taxed under the same formula in the future.

8. *Effective dates.*—The amendments made by this section are to apply with respect to taxable years beginning after December 31, 1962 (except that the effective date relating to mutual marine insurance companies is taxable years beginning after December 31, 1961).

XII. DOMESTIC CORPORATIONS RECEIVING DIVIDENDS FROM FOREIGN CORPORATIONS

(Sec. 11 of the bill and secs. 902 and 78 of code)

A. Reasons for provision

The President in his tax message to Congress last year stated that the method by which the credit for foreign income tax is computed in the case of dividends involves, in effect, a double allowance for foreign income taxes and should be corrected.

The problem arises when the foreign tax rate is below the U.S. tax rate and results from the fact that the amount paid in foreign taxes not only is allowed as a credit in computing the U.S. tax of the corporation receiving the dividend, but also is in effect allowed as a deduction (since the dividends can only be paid out of income remaining after payment of the foreign tax).

The problem can be illustrated by assuming that a foreign government imposes a 30-percent tax with respect to \$1,000 of income of a

corporation. This would leave \$700 of the \$1,000 out of which a dividend could be paid to a U.S. parent corporation. If the applicable U.S. tax rate is 52 percent, the American tax on this \$700 before the allowance of any foreign tax credit would be \$364. On the other hand, if the \$1,000 of income had been earned by a branch of the U.S. corporation, the entire \$1,000 would be subject to U.S. tax before allowance of any foreign tax credit. Thus, in this case the tentative U.S. tax would be \$520, or \$156 more than in the case of the foreign subsidiary.

In the case of the foreign subsidiary, the foreign tax allowed as a credit is limited to the same proportion of the tax which the income included in the American tax base is of the total income.¹ Thus, the allowable credit in the case of the foreign subsidiary is limited to seven-tenths of the \$300 or is limited to \$210. As a result the final U.S. tax on the dividend is \$154 (\$364 minus \$210). This U.S. tax of \$154, plus the foreign tax of \$300, results in a total tax of \$454, which is \$66 less than the full \$520 tax which would be paid by a domestic corporation operating in this country, or operating abroad through a branch.²

The size of this tax differential which exists in the case of dividends from foreign subsidiaries at the present time varies with the size of the foreign tax rate. As shown in table 1, the tax differential disappears either when the foreign tax rate equals or exceeds the U.S. tax or when there is no foreign tax imposed at all. The maximum tax differential, given a 52-percent U.S. tax rate, occurs when the foreign tax rate is half that, or 26 percent. The differential at this point is 6.7 percentage points.³ Where dividends are received by a domestic corporation from its subsidiary, which in turn has received its income from a subsidiary, the maximum tax differential (given the 52-percent U.S. tax rate) amounts to 11.93 percentage points.

TABLE 1.—Rate differential enjoyed with respect to dividends from foreign subsidiaries with various selected foreign income tax rates and present 52-percent U.S. rate

Income before tax	Foreign tax	Income available for dividend	U.S. tax before credit	Credit against U.S. tax	U.S. tax	Total tax	Rate differential enjoyed by foreign subsidiary
							Percentage points
\$100-----	0	\$100	\$52.00	0	\$52.00	\$52.00	0
\$100-----	5	95	49.40	\$4.75	44.65	49.65	2.35
\$100-----	10	90	46.80	9.00	37.80	47.80	4.20
\$100-----	20	80	41.60	16.00	25.60	45.60	6.40
\$100-----	26	74	38.48	19.24	19.24	45.24	6.76
\$100-----	30	70	36.40	21.00	15.40	45.40	6.60
\$100-----	40	60	31.20	24.00	7.20	47.20	4.80
\$100-----	50	50	26.00	25.00	1.00	51.00	1.00
\$100-----	52	48	24.96	24.96	0	52.00	0

¹ This is the result of the decision in *American Chicle Company v. U.S.*, 316 U.S. 450 (1942).

² As indicated above, the U.S. tax before credit in the case of the branch would be \$520. After allowing the \$300 foreign tax credit in this case, the final U.S. tax would be \$220 which, with the \$300 of foreign tax means a total tax of \$520.

³ The tax differential represents the difference between the U.S. and foreign tax rates, multiplied by the income omitted from the U.S. tax base.

Your committee agrees with the President that in the interest of uniform tax treatment this double allowance in the case of dividends from foreign corporations should be removed. This is accomplished by providing that where a taxpayer elects the foreign tax credit, he must increase, or "gross-up," his U.S. tax base by including in it the amount of foreign income paid in taxes which is attributable to the dividend received. Thus, in the example cited above, the tentative U.S. tax would be computed on the basis of \$1,000, instead of \$700, and then the full \$300 of foreign taxes would be allowed as a tax credit, in the same way as branches of U.S. corporations are treated at the present time.

Two relatively minor technical corrections recommended by the administration are also included with this provision. One of these involves the repeal of a subsection (sec. 902(d)) of one of the foreign tax credit provisions, which makes the foreign tax credit available in limited cases with respect to royalty income received from a foreign subsidiary. This royalty income is entitled to this foreign tax credit only where the domestic corporation owns all of the stock of the subsidiary. The provision granting this treatment in the case of royalty income was adopted in 1954 in order to grant relief in a case where under currency exchange restrictions, a corporation was prohibited from distributing its earnings. The retention of this provision appears undesirable, since it has the effect of allowing a foreign tax credit before actual dividend distributions have been made. Your committee's bill, therefore, repeals this subsection.

Second, the bill also follows a recommendation of the administration relating to the interrelationship of the foreign tax credit and the intercorporate dividends received deduction. The problem arises here where a foreign corporation derives 50 percent or more of its income from sources within the United States. In such a case a domestic corporation receiving dividends from it is eligible for the 85-percent intercorporate dividends received deduction. This deduction is available with respect to the proportion of the income determined to be from sources within the United States. However, all of the remaining income is treated as income from sources without the United States for which a foreign tax credit is available, including the 15-percent amount remaining after the allowance of the intercorporate dividends received deduction which, for that purpose, was treated as income from sources within the United States. The administration recommended that this 15 percent of domestic source income, remaining after the dividend received deduction is allowed, retain its domestic source character rather than being reclassified as foreign source income for purposes of the foreign tax credit. Your committee's bill makes this modification.

B. General explanation of provision

1. *Elimination of double allowance.*—The provision adds a new section to the code (sec. 78) which provides that if a domestic corporation elects to take the foreign tax credit (rather than a deduction for foreign taxes) it must take into its gross income an amount equal to the taxes of the subsidiary (or an amount equal to the taxes of its subsidiary's subsidiary) it is considered, or deemed, to have paid for

purposes of the foreign tax credit provision. Thus, for a domestic corporation to claim a foreign tax credit for foreign taxes paid by its subsidiary or a subsidiary of that subsidiary, it must "gross up" its dividend income received by the amount of the foreign income, etc., taxes attributable to it.

Other provisions of the code (sec. 902 (c), (a), and (b)) are also amended to carry out fully the "gross-up" referred to in the prior paragraph. Thus, the definition of the term accumulated profits for purposes of the foreign tax credit is modified to include the income and similar taxes imposed by a foreign country (or U.S. possessions) which are taken into account by the domestic corporation.

2. *Dividends from U.S. sources.*—The bill amends the rules used in determining whether income is from within or without the United States in the case of a foreign corporation which has received 50 percent or more of its gross income for the 3 prior years from sources within the United States. In such a case, the 85-percent intercorporate dividends received deduction is available with respect to the proportion of its income which its income for the 3-year period derived from sources within the United States bears to its income from all sources. However, under present law all of such a corporation's income, to the extent it exceeds the 85-percent deduction allowed for intercorporate dividends received, is treated (for purposes of the foreign tax credit) as income from sources without the United States. Thus, the 15 percent for which no intercorporate dividends received deduction is allowed, although for purposes of the prior computation treated as from sources within the United States, is for this purpose treated as foreign source income. The bill corrects this technical deficiency by providing that the amount treated as foreign source income in such a case is only the remaining income in excess of this 15 percent.

3. *Royalty income eligible for foreign tax credit.*—The bill repeals the provision of present law (sec. 902(d)) which treats as a distribution (and, therefore, eligible for the foreign tax credit) royalty payments received by a domestic corporation from a 100-percent owned subsidiary engaged in manufacturing, production, or mining.

4. *Effective date.*—The provisions referred to above are applicable to *all* dividends received by a domestic corporation after December 31, 1964. They also are to apply to *certain* dividends received by the domestic corporation in the period before January 1, 1965, but only in its taxable years beginning after December 31, 1962. For a calendar year corporation this latter category includes certain dividends received in the calendar years 1963 and 1964. In the case of dividends received in these years the "gross-up" and other changes made by this provision are to apply only to the extent that the dividends are treated for tax purposes as made out of the accumulated profits of the foreign corporation for taxable years beginning after December 31, 1962. Dividends received by a foreign corporation from its subsidiary before January 1, 1965, which are paid out of the subsidiary's profits from before 1963, are to be treated as paid out of the first foreign corporation's profits from before 1963 if it in turn pays the dividends to the domestic corporation before January 1, 1965.

XIII. EARNED INCOME FROM SOURCES OUTSIDE THE UNITED STATES

(Sec. 12 of the bill and secs. 911 and 72(f) of the code)

A. Reasons for provision

Under present law an individual citizen of the United States who is a bona fide resident of a foreign country may exclude from his U.S. tax base his entire earned income from sources outside of the United States. In addition, an individual who goes abroad, but does not establish a foreign residence, may exclude from his U.S. tax base his earned income up to \$20,000 a year if he remains abroad for a period of 17 out of 18 consecutive months.

The President recommended that in the case of citizens living abroad in developed countries there be no exclusion for income earned abroad. In the case of less developed countries he would keep the present exclusion of up to \$20,000 a year in the case of those who are abroad 17 out of 18 months, and also provide the same \$20,000 ceiling with respect to those who are bona fide residents of a foreign country.

Your committee's bill provides a ceiling on the exclusion for income earned abroad. However, it has not attempted to distinguish between U.S. citizens residing or present in developed and those in less developed countries. As a result, it has retained the 17-out-of-18-month provision of present law without any major change in the presently applicable \$20,000 ceiling. In the case of a bona fide resident of a foreign country your committee's bill also provides the same \$20,000 limitation for the first 3 years the individual is abroad. However, if the individual is abroad for an uninterrupted period of more than 3 consecutive years a higher ceiling of \$35,000 is provided. Thus, during the first 3 years an individual is abroad the exclusion will be the same, whether the individual is a bona fide resident of the foreign country or merely there for 17 out of 18 months. However, in recognition of the fact that those who are abroad for longer periods of time are more dependent on the foreign economy, and less upon the U.S. economy, the higher ceiling of \$35,000 is provided in the case of these longer stays.

A second recommendation of the administration in this area relates to pensions and deferred compensation paid to U.S. citizens, after they are back in the United States, but with respect to periods of time they were abroad.

In the case of pensions generally, an employee receives back over his period of life expectancy (or in some cases in the first 3 years) the amount he paid toward his pension. The remainder of the pension payments he receives, consisting of contributions by the employer and interest on the funds while they were accumulating, is taxable to him as the pension or annuity payments are received.

In the case of a citizen who has been a bona fide resident of a foreign country, or been in a foreign country for a period of 17 out of 18 months or more, the employer contributions toward the pension fund during the period he was abroad are treated in the same manner as his own contributions and, therefore, are not taxable to him when he draws his pension or annuity upon retirement. This is true even though he may be living in the United States next to someone who

has worked for the same employer in the United States and is fully taxable on contributions made by the same employer.

To remove this discrimination the bill provides that contributions by an employer will, to the extent that they relate to future employment, be fully taxable to the employee when he receives the pension payments reflecting these contributions. Thus, for the future even though employer contributions are attributable to a period when the employee was abroad after 1962, these contributions by the employer will be taxable to him in the same manner as in the case of a domestic worker also receiving a pension. This will be true whether the employee is living in the United States, or abroad, at the time of the receipt of the pension payment.

Also, under your committee's bill deferred compensation arrangements where an individual receives the deferred compensation after the end of the taxable year following the year in which the services were performed is not to be eligible for the exclusion for income earned abroad. The purpose of the exclusion is to provide a special inducement for American citizens or residents to hold employment abroad. Your committee sees no reason, however, to provide this special inducement long after the period in which the employment occurred. Moreover, this will treat deferred compensation under the exclusion the same as qualified pensions.

B. General explanation of provision

1. *Ceiling on earned income exclusion.*—Your committee's bill places a ceiling on the amount which may be excluded from income in the case of a citizen of the United States who is a bona fide resident of a foreign country or countries. The bill provides that the total amount which may be excluded with respect to the first 3 years an individual is abroad as a bona fide resident is \$20,000 a year. This is the same ceiling which presently is applicable in the case of citizens or residents of the United States who are abroad for a period of 17 out of 18 months. However, in the case of the U.S. citizen who is a bona fide resident of a foreign country or countries for more than 3 years, the total amount which may be excluded in this case is to be \$35,000 under the bill instead of \$20,000. This higher ceiling is to apply with respect to any portion of a taxable year remaining after the individual has been a bona fide resident of a foreign country or countries for the uninterrupted 3-year period. Where at the time of the passage of this legislation the individual already has been a bona fide resident for 3 years or more, this higher ceiling will, of course, become applicable immediately.

In applying either the \$20,000 or \$35,000 ceilings under community property laws the total community income excludable may not exceed the amount which would be excludable if this income were not community income. Thus, one \$20,000 or \$35,000 ceiling will apply with respect to the husband's earnings abroad even though under community property law, half of this income is the income of the wife. However, if both husband and wife are abroad and earn income, separate ceilings will be applied with respect to their earnings attributable to the services of each.

2. *Deferred compensation.*—Under present law the bona fide resident rule and the 17- out of 18-month rule work somewhat differently in determining the year to which the exclusion relates. The bona fide

resident rule at present provides an exclusion without limit for amounts received from sources without the United States which are "attributable" to the period when the U.S. citizen was a bona fide resident of a foreign country. This means that deferred compensation attributable to a period of foreign service is excludable even though received many years after the period of service.

The 17- out of 18-month rule, however, because of the \$20,000 ceiling, has been interpreted as limiting the exclusion which an individual may receive to the proportion of the year, during which the payment was received, in which the individual was abroad. Thus, where the individual receives deferred compensation after he is back in the United States for an entire year, no exclusion is available. Moreover, in this latter case, hardship situations have occurred where an individual, who has returned to the United States early in a year, has received payments attributable to service in the prior year, but because the individual is in the United States most, or all, of the year little, or no, exclusion is available with respect to this income.

Your committee eliminates the problems referred to above by attributing the income, for purposes of applying the dollar limitation on the exclusion, to the year in which the service is performed. This means that the exclusion, merely because the individual has returned to the United States before receiving the payment, will not be denied. However, deferred compensation is made ineligible for the exclusion by providing that no exclusion will be allowed for amounts received more than 1 year after the close of the taxable year in which the services are performed.

3. *Pension income.*—The provision of present law dealing with annuities (sec. 72(f)) provides that in determining what the employee or annuitant paid for an annuity contract, there is to be included contributions of the employer, if, had these contributions been paid to the employee in the first instance, they would not have been taxable to him. This provision generally has the effect of excluding employer contributions to a pension plan from tax where the employee is abroad and qualifies for the exclusion.

The bill nullifies this section by providing that the exclusion for income earned abroad is not to be available in the case of amounts received as pensions or annuities or amounts which otherwise would be included in gross income in the case of beneficiaries of tax-exempt trusts (sec. 402(b)), beneficiaries under nonqualified annuities (sec. 403(c)), or beneficiaries under certain forfeitable contracts purchased by exempt organizations (sec. 403(d)).

The bill also makes it clear that the tax-free status of employer contributions will be continued in the case of contributions made after December 31, 1963, to the extent that they provide pension or annuity credits where these credits are attributable to services performed on or before that date if the pension or annuity plan provisions were in existence on February 1, 1962.

4. *Effective date.*—The changes made by this provision are to apply to amounts received after December 31, 1962, but only to the extent that these amounts are attributable to services performed after that date or services performed on or before that date, where before February 1, 1962, there did not exist a right to receive these amounts.

XIV. CONTROLLED FOREIGN CORPORATIONS

(Sec. 13 of bill and secs. 951-958 of code)

A. Reasons for provision

Under present law foreign corporations, even though they may be American controlled, are not subject to U.S. tax laws on foreign source income. As a result no U.S. tax is imposed with respect to the foreign source earnings of these corporations where they are controlled by Americans until dividends are paid by the foreign corporations to their American parent corporations or to their other American shareholders. The tax at that time is imposed with respect to the dividend income received by the American shareholder, and if this shareholder is a corporation it is eligible for a foreign tax credit with respect to the taxes paid by the foreign subsidiary. In the case of foreign subsidiaries, therefore, this means that foreign taxes are paid currently, to the extent of the applicable foreign income tax, and not until distributions are made will an additional U.S. tax be imposed, to the extent the U.S. rate is above that applicable in the foreign country. This latter tax effect has been referred to as "tax deferral."

The President in his tax message last year questioned the desirability of providing tax deferral with respect to earnings of U.S.-controlled companies except in the case of investments in less developed countries. However, his primary emphasis was on removing tax deferral in the case of what have been called "tax havens." In this respect he stated:

The undesirability of continuing deferral is underscored where deferral has served as a shelter for tax escape through the unjustifiable use of tax havens such as Switzerland. Recently more and more enterprises organized abroad by American firms have arranged their corporate structures—aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices which maximize the accumulation of profits in the tax haven—so as to exploit the multiplicity of foreign tax systems and international agreements in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad.

In this area the President recommended the:

* * * elimination of the tax haven device anywhere in the world, even in the underdeveloped countries, through the elimination of tax deferral privileges for those forms of activities, such as trading, licensing, insurance, and others, that typically seek out tax haven methods of operation. There is no valid reason to permit their remaining untaxed regardless of the country in which they are located.

Your committee's bill does not go as far as the President recommendations. It does not eliminate tax deferral in the case of operating businesses owned by Americans which are located in the economically developed countries of the world. Testimony in hearings before your committee suggested that the location of investments in these countries is an important factor in stimulating American exports to the same areas. Moreover, it appeared that to impose the U.S. tax currently

on the U.S. shareholders of American-owned businesses operating abroad would place such firms at a disadvantage with other firms located in the same areas not subject to U.S. tax.

Nevertheless, the testimony before your committee did convince it that many have taken advantage of the multiplicity of foreign tax systems to avoid taxation by the United States on what could ordinarily be expected to be U.S. source income. In part your committee has met this problem elsewhere in this bill (sec. 6) through the addition of a new subsection to the existing section 482 setting up specific factors to be taken into account in more accurately allocating income from purchases and sales of goods between American corporations and their controlled foreign subsidiaries. However, certain of the provisions set forth in this section are also designed to meet this problem of diversion of income from U.S. taxation. This is true, for example, of the provisions taxing to the U.S. shareholders foreign income arising from controlled foreign corporations in the case of insurance on American risks. This is also true of the provision taxing income derived by controlled foreign corporations from patents, copyrights, etc., developed in the United States.

Your committee has also concluded that U.S. tax should be imposed currently, on the American shareholders, on income which is held abroad and not used in the taxpayer's trade or business unless, in accord with the policy enunciated by the President, it is invested in businesses in less developed countries. Because of this your committee's bill taxes to U.S. shareholders investment-type income not invested in less developed countries and also income which may arise from the active conduct of a trade or business if the income is not re-invested in the same business (outside of the United States) or in a less developed country.

A third objective of the tax measures described below is to prevent the repatriation of income to the United States in a manner which does not subject it to U.S. taxation. This accounts for section 16 of this bill which gives assurance that upon the liquidation of a corporation, the redemption of stock, or the sale of stock in a controlled foreign corporation the earnings and profits of the corporation—not previously subject to tax by United States—are to be so taxed to the extent of the excess of the U.S. tax over the foreign tax. This objective also accounts for some of the features of this provision, which deny tax deferral where funds are brought back and invested in United States in a manner which does not otherwise subject them to U.S. taxation.

Your committee also has ended tax deferral for American shareholders in certain situations where the multiplicity of foreign tax systems has been taken advantage of by American-controlled businesses to siphon off sales profits from goods manufactured by related parties either in United States or abroad. In such cases the separation of the sales function is designed to avoid either U.S. tax or tax imposed by the foreign country.

B. General explanation of provision

1. *In general.*—The bill provides that certain undistributed income of controlled foreign corporations is to be included in the income of U.S. shareholders in the year the income is earned by the foreign corporation, whether or not it is distributed. In these cases, the share-

holders are permitted foreign tax credits to the same extent as if actual distributions had been made. The U.S. shareholders, or "U.S. persons" as they are called in the bill, are defined as including U.S. citizens and residents and domestic corporations, partnerships, and estates or trusts. As indicated, this income is taxed to the U.S. shareholders only in the case of "controlled foreign corporations." A foreign corporation is controlled for this purpose when more than 50 percent of the combined voting power of all classes of stock is owned directly or indirectly (through the stock attribution rules specified) by U.S. persons on any day of the taxable year of the corporation. (A special, additional rule provided in the case of insurance is discussed subsequently.)

Not all U.S. persons who are shareholders in such a controlled foreign corporation, however, are to have attributed to them the specified types of foreign income of a controlled foreign corporation. This is to be done only in the case of those having on any day during the year a stock ownership of 10 percent or more of the combined voting power of all classes of stock, or of the total value of shares of all classes of stock. This *de minimis* rule prevents the attribution of the undistributed income back to the shareholders where their interest is small and their influence on the corporation's policy is presumably negligible. The 10-percent ownership test is determined by applying stock ownership attribution rules set forth in the bill.

There are two groupings of income under this provision which may result in income being attributed to the shareholders and their being taxed on it. The first category of such income is known in the bill as "subpart F income." This consists of: (1) income derived from insurance on U.S. risks on property or persons; (2) income derived from patents, copyrights, and exclusive formulas and processes which were developed in the United States; and (3) certain so-called net foreign base company income. In general, this foreign base company income consists of income from passive sources—such as dividends, interest, rents, etc., and also certain income from sales subsidiaries (to the extent these income categories are not reinvested in less developed countries). This subpart F income under the bill is attributed to 10-percent U.S. shareholders and taxed to them in largely the same manner as dividends.

A second category of earnings may also give rise to the corporation's income being taxed to 10-percent-or-more U.S. shareholders. This is the increase in the earnings invested during the year in what is called "nonqualified property." In general terms investments in nonqualified property consist of investments not required in the taxpayer's trade or business and not invested in a less developed country. Nonqualified property also includes most investments in the United States whether or not the property is used in the taxpayer's trade or business. The earnings representing an increase in investments in nonqualified property are treated first as coming out of the subpart F income already taxed. To the extent of this income, therefore, earnings representing this nonqualified property category do not result in any additional tax for the shareholders. Only when the earnings invested in nonqualified property exceed the accumulated balance of any subpart F income (including both subpart F income for

the current year and any prior years) which was not previously offset by the nonqualified property category is the income to be taxed to the U.S. shareholders.

Just as the invested earnings in nonqualified property are treated as being first out of subpart F income, so actual dividend distributions are treated first as being paid out of the earnings invested in nonqualified property, then out of subpart F income, and only finally, if any balance remains, out of the accumulated earnings of the corporation which have not already been taxed to the shareholders. Only when the actual dividends are treated as paid out of this latter category do they represent taxable dividends to the shareholders.

The earnings of a corporation classified as subpart F income, or as earnings invested in nonqualified property, give rise to taxable income to the shareholders only for the portion of earnings represented by the portion of the year in which the corporation was a controlled foreign corporation. Also, it will be necessary to maintain separate balances of earnings and profits with respect to different shareholders during the year, because there may be differences as to whether they are 10-percent stockholders or not, and also because such stockholders may increase or decrease their stockholdings during the year.

2. *Income derived from insurance of U.S. risks.*—Since the passage of the Life Insurance Company Income Tax Act of 1959, which for the first time in many years imposed a tax on underwriting gains of these companies, it is understood that a number of the companies involved have attempted to avoid tax on the gains by reinsuring their policies abroad. In other cases the tax has been avoided by placing the initial policy with a foreign insurance company either controlled by an American insurance company or controlled by other American businesses.

To meet this problem your committee's bill provides that where a controlled foreign corporation receives premiums or other consideration for reinsurance or the issuing of insurance or annuity contracts on property in, or residents of, the United States the income attributable to this is to be taxed to the U.S. shareholders as a part of subpart F income.

The bill also covers the type of situation where the controlled foreign corporation does not hold the policies involving U.S. risks but instead holds other policies which, by arrangement with another unrelated corporation, it has received instead of the insurance involving the U.S. risks, while the unrelated corporation holds the policies involving the insurance on property in, or residents of, the United States.

In the case of insurance there also is an alternative definition of a controlled foreign corporation. Under the alternative if U.S. persons hold from 25 to 50 percent of the stock, any income from insurance or reinsurance on U.S. risks is included in income taxed as subpart F income where the U.S. risks represent 75 percent of the gross amount of all premiums and other considerations with respect to risks held by the company. This alternative rule for control is designed to cover cases where the principal business is the U.S. risks but the control is decreased in order to avoid the application of this provision.

The income subject to tax in the hands of the shareholders in the case of life insurance companies is total gain from operations to the extent attributable to U.S. risks. In effect this represents all (not 50 percent) of the underwriting income as well as net investment income.

In the case of fire, casualty, and similar insurance companies, the income subject to tax will be the same whether the company is a mutual or stock company since the stock company rules for this purpose are made applicable to the mutual. Certain deductions generally allowed domestic insurance companies will not be allowed in the case of these foreign operations. The deductions which are disallowed for life insurance business include the operations loss deduction, the deduction for certain nonparticipating contracts, the deduction for group life, accident, and health insurance, and the small business deduction. Other modifications are also provided. The income ascribed to the shareholders will be the income relating to the insurance or reinsurance on the U.S. risks, taking into account expenses, losses, and deductions properly allocable to this income.

3. *Income from U.S. patents, copyrights, etc.*—The second component of the subpart F income which will be taxed to the U.S. shareholders in the case of controlled foreign corporations is income from U.S. patents, copyrights, and exclusive formulas and processes. For the income from these patents, copyrights, etc., to be included they must have been substantially developed, created, or produced in the United States, or, alternatively, acquired directly or indirectly from related U.S. persons. Your committee concluded that it was desirable to tax this income to the U.S. shareholders on the grounds that where a patent, copyright, etc., was developed or created in the United States, it is likely that, if it were not for lower taxes abroad, the rights to it would still be held by the domestic company with this company merely licensing its use by the foreign corporation. This, of course, would result in rental or royalty income taxable to the U.S. company.

The income to be taxed here is that derived from the license, sublicense, sale, exchange, use, or other means of exploitation of the patent, copyright, exclusive formula, or process. From this income there is to be deducted the expenses incurred by the controlled foreign corporation, including taxes paid foreign countries, with respect to this income, and any amortization or depreciation of the cost of the patent, copyright, etc.

Income from patents, copyrights, etc., is attributed to U.S. shareholders not only where the foreign corporation receives a royalty or similar payment for the use of the property, but also where the foreign corporation itself uses the patent, copyright, or exclusive formula or process in the manufacture of goods and derives income from the sale of the manufactured articles. In such a case the income derived from the patent, etc., is to be considered as the amount which would be obtained as a gross rent, royalty or other payment in an arm's-length transaction with an unrelated person from the similar use of this patent, etc. The amount so determined is not intended to be merely a percentage of the taxable income derived from the products manufactured and sold and, therefore, there is no intention that manufacturing, production or similar expenses are to be taken into account in determining the net royalty or rental payment.

4. *Net foreign base company income.*—The two income components of subpart F income discussed above are in both cases taxed to the U.S. shareholders without any reductions for reinvestment. What is described here as "foreign base company income," however, may be reduced for qualified investment in less developed countries made during the taxable year (or in the first 2½ months thereafter). This

accounts for the reference to "net" in this income category. The investments which may be made in less developed countries in this case are the same as two of the categories described in connection with reinvestments permitted in the case of qualified property. This is developed further below.

The foreign base company income consists of two basic parts: passive investment income, or more precisely "foreign personal holding company income" with certain modifications described below, and "foreign base company sales income."

Your committee while recognizing the need to maintain active American business operations abroad on an equal competitive footing with other operating businesses in the same foreign countries, nevertheless sees no need to maintain deferral of U.S. tax where the investments are portfolio types of investments, or where the company is merely passively receiving investment income. In such cases there is no competitive problem justifying postponement of the tax until the income is repatriated.

The passive income referred to here is the same as "foreign personal holding company income" except that rental income is included whether or not rents represented more than 50 percent of the gross income involved. An exception is also made for income of banks and bank subsidiary organizations since in such cases the receipt of interest and other similar types of income do not result from passive investments. Those excluded by this provision are corporations organized and doing business under the banking and credit laws of a foreign country. Also excluded are foreign corporations where 50 percent or more of their stock is held by domestic corporations organized under section 25(a) of the Federal Reserve Act or having an agreement with the Board of Governors of the Federal Reserve System under the same section of the Federal Reserve Act. These are the so-called Edge Act corporations. Under the bill all of their stock (except qualifying shares) must be owned by a national or State bank which is a member of the Federal Reserve System.

The "foreign base company sales income" referred to here means income from the purchase and sale of property without any appreciable value being added to the product by the selling corporation. This does not, for example, include cases where any significant amount of manufacturing, installation, or construction activity is carried on with respect to the product by the selling corporation. On the other hand, activity such as minor assembling, packaging, repackaging, or labeling would not be sufficient to exclude the profits from this definition.

The bill provides that this sales income is to be taken into account as foreign base income only where it represents at least 20 percent of the gross income of the foreign corporation. The 20 percent is to be computed without taking into account the passive income of the foreign corporation.

The sales income with which your committee is primarily concerned is income of a selling subsidiary (whether acting as a principal or agent) which has been separated from manufacturing activities of a related corporation merely to obtain a lower rate of tax for the sales income. As a result, this provision is restricted to sales of property to a related person or purchases of property from a related person. Moreover, since the lower tax rate for such a company is likely to be

obtained through purchases and sales outside of the country in which it is incorporated, the provision is made inapplicable to the extent the property is manufactured, produced, grown, or extracted in the country where the corporation is organized or where it is sold for use, consumption, or disposition in that country. Mere passage of title, however, is not intended to be determinative of the location of the purchase or sale for this purpose.

Where the foreign base company gross income (before deduction for any reinvestment) is less than 20 percent of the gross income it is not taken into account in computing subpart F income. On the other hand, where it exceeds 80 percent of the gross income of a corporation, the entire gross income (less deductions) is to be classified as foreign base company income. Where this income is from 20 percent to 80 percent of the company's gross income, only the foreign base company income is taken into account. These rules are similar to those set forth in an earlier provision (sec. 7) of this bill with respect to foreign personal holding company income. Thus, where this foreign base company income is relatively minor, the shareholders will not be taxed on any of it; where it is a major factor, they are to be taxed on the entire income of the corporation. Otherwise only the foreign base company income is taken into account.

The net foreign base company income which may constitute subpart F income is the foreign base company less investment in qualified property in less developed countries. The qualified investments income are investments in stock in a controlled corporation in a less developed country or any investments which are required because of restrictions imposed by a less developed country (including investments previously so required which would result in a substantial loss if now withdrawn). These are two of the categories in which reinvestment is permitted in the case of the next category of income described below, and are discussed in greater detail at that point. In determining these reinvestments taken into account it is only the increases over the investments held at the end of the preceding year which are taken into account.

5. Earnings invested in nonqualified property.—The categories of income referred to up to this point are the components of the "subpart F income." As previously indicated, these are taxed to the shareholders in all cases. In addition, however, the increase in earnings invested in nonqualified property may also be taxed to the shareholders. However, this income is taxed to the shareholders only to the extent it exceeds any balance of subpart F income remaining (not only for the current year but also for prior years) which has not previously been offset by earnings invested in nonqualified property. In this manner it is possible to prevent the same amount from being attributed to the shareholder for tax purposes more than once. The rule provided here in effect assumes that any increases in investments in nonqualified property are made first out of this subpart F income already taxed to the shareholders.

Since the concept here is merely to tax to the U.S. shareholders the earnings and profits of the corporation since the end of 1962, the investments in nonqualified property taken into account are only those which are in excess of earnings and profits accumulated in taxable years beginning after December 31, 1962. With respect to any year, therefore, the increase in nonqualified property is the excess of property

of this type at the end of the current taxable year over property of this type as of the end of the prior taxable year.¹

Since it is not intended that this provision in any sense be retroactive, only nonqualified property acquired after December 31, 1962, is taken into account. This means that a record will have to be maintained of nonqualified property as of December 31, 1962, in order to keep these amounts of nonqualified investments, previously made, from resulting in a tax in subsequent years.

Your committee in determining what constitutes qualified property concluded that for competitive reasons the foreign corporation should be able to expand its investments in the same trade or business (or substantially the same trade or business) wherever it was located. Thus, money or other property located outside of the United States which is ordinary and necessary to the active conduct of a qualified trade or business of the controlled corporation is considered qualified property. In order to prevent foreign corporations from starting relatively small trades or businesses (incurring relatively small penalties in denial of deferment) and then permitting additions in later years to these investments to qualify as investments in the corporation's "trade or business," the bill provides a 5-year "seasoning" rule. Thus, only where the corporation has engaged in a trade or business for the past 5 years with additional investments in it qualify as in the "corporation's trade or business." However, any trade or business in which the foreign corporation was engaged in on December 31, 1962, will also qualify without regard to the 5-year rule. In addition, any active trade or business carried on directly by the foreign corporation in a less developed country will qualify for investments of earnings. Investments in an 80-percent-owned subsidiary qualify in the same way as investments in the foreign corporation's own trade or business, if the stock was owned continuously since December 31, 1962, or has been held for the 5 years preceding the taxable year in question.

In addition to investments in a controlled foreign corporation's own trade or business, qualified property also includes stock acquisitions in a subsidiary where the corporation and no more than four other U.S. persons own directly or indirectly more than 50 percent of the voting stock of the corporation and the investing corporation owns at least 10 percent. However, this type of investment will qualify only if the subsidiary is engaged in the active conduct of a trade or business almost wholly within a less developed country or countries and is organized under the laws of such a country. It was recognized, however, that in some cases the 50-percent test referred to above may be impossible to meet because the laws of the country involved do not permit foreigners to own so high a percentage of the voting stock of certain types, or all types, of local corporations. Where there are such laws the maximum ownership required, in lieu of the 50 percent, is to be whatever lower maximum is permitted by the laws of the specific foreign country involved.

Generally, property of the controlled foreign corporation cannot be located within the United States and still be qualified property.

¹ Since actual dividend distributions are treated as made first out of amounts taxed to shareholders as increases in earnings invested in nonqualified property, to the extent that actual distributions are treated as made out of this nonqualified property balance it is necessary to reduce the balance of nonqualified property as of the close of the prior year by the amount which now has been actually distributed. If this were not done it would be possible to retain the nonqualified investments in the corporation and make actual distributions out of other property to the shareholders which would not be taxable to them.

Certain exceptions, however, are made but these apply only where the property located within the United States is ordinary and necessary to the active conduct of the foreign corporation's business or substantially the same trade or business, and then only if the property represents—

- (1) investments in U.S. bonds, money, or bank accounts,
- (2) property purchased in the United States for export to, or use in, a foreign country, or
- (3) loans arising in connection with the sale of property where the amount of the loan outstanding does not exceed the amount which would be ordinary and necessary in the trade or business of both the lending and borrowing corporation had the sale been between unrelated persons.

Generally, bringing earnings back to the United States is disallowed unless the shareholders have paid tax on these earnings. The exceptions noted above, however, are believed to be normal commercial transactions without any intention to permit the funds to remain in the United States indefinitely.

6. *Less developed countries.*—For both the foreign base company income provision in the subpart F income and also for purposes of the increase in earnings taxed to the shareholders in the case of investments in nonqualified property, investments are allowed as offsets if they are made in "less developed countries." Less developed countries under the bill are defined as foreign countries (other than areas within the Sino-Soviet bloc) or possessions of the United States where the President of the United States has designated such a country or possession as economically less developed.² However, the following countries are in no event to be considered as less developed countries:

Australia	Luxembourg
Austria	Monaco
Belgium	Netherlands
Canada	New Zealand
Denmark	Norway
France	Union of South Africa
Germany (Federal Republic)	San Marino
Hong Kong	Sweden
Italy	Switzerland
Japan	United Kingdom
Liechtenstein	

7. *Foreign tax credit.*—U.S. shareholders who are taxed on subpart F income, or on the increase of earnings invested in nonqualified property, can obtain a foreign tax credit for foreign income, etc., taxes paid by the foreign corporation, if the shareholder is a person to whom such a foreign credit would be allowed in the case of an actual distribution. That means that foreign tax credits will be allowed where the shareholder is a domestic corporation holding the stock of a foreign corporation and it has at least a 10-percent voting stock interest. Similarly, where a domestic corporation has at least a 10-percent interest in a foreign corporation which in turn has at least a 50-percent voting stock interest in a subsidiary, then a foreign tax credit

² Overseas territories, departments, provinces or possessions for this purpose may be treated as separate countries. Thus, even though the "home" country may be classified as developed, the overseas area may be considered less developed.

will be allowed the U.S. shareholder with respect to the earnings of this subsidiary when undistributed earnings of the subsidiary are taxed to the U.S. corporate shareholder. Taxes so allowed as credits will not again be allowed as credits when actual distributions are made.

Where the foreign country imposes a tax directly on dividend distributions, such a tax would not, of course, initially be taken into account when the shareholder at an earlier date was taxed on undistributed earnings of a controlled foreign corporation. These taxes on actual dividend payments, however, will be allowed as credits in the year in which the actual dividends are paid, even though these dividends are not taxable to the domestic corporation receiving them because of an earlier inclusion by it of these amounts in its income. Adjustments are made in the overall and per country limitations to keep these limitations from reducing the creditable taxes in such cases below what could be credited if the income taxed and taxes attributable to this income had been taken into account in the same year. Moreover, if the taxpayer has insufficient income against which to offset such credits in the year of the actual distribution, then refunds are allowed.

8. *Adjustments to basis of stock.*—It is necessary where amounts not actually distributed to the taxpayer are nevertheless taxed to him, to increase his basis for the stock in the controlled corporation by the amount so taxed to him. However, if subsequently actual distributions are made which do not result in any tax to the shareholder because of the prior tax payment by him, then the basis of the stock needs to again be reduced. The bill makes provision for these adjustments.

9. *Effective date.*—This provision applies to taxable years of foreign corporations beginning after December 31, 1962, and to taxable years of U.S. persons ending within or with these taxable years of the foreign corporations.

XV. GAIN FROM DISPOSITION OF DEPRECIABLE PERSONAL PROPERTY

(Sec. 14 of bill and secs. 1245, 167(f), 170(e) and 453(d) of code)

A. *Reasons for provision*

Under present law, in the case of depreciable property the taxpayer may write off the cost or other basis of the property over the period of the useful life of the asset in his hands. This cost or other basis can be written off evenly (or in a "straight line" over the asset's life), under the declining balance method, under the sum-of-the-year's digits method, or under any other consistent method which does not during the first two-thirds of the useful life of the property exceed the allowances which would have been allowed under the declining balance method. This depreciation deduction is a deduction against ordinary income. If either the useful life of the asset is too short, or the particular method of depreciation allows too much depreciation in the early years, the decline in value of the asset resulting from these depreciation deductions may exceed the actual decline of the value of the asset. Wherever the depreciation deductions reduce the basis of the property faster than the actual decline in its value, then when it is sold there will be a gain. Under present law this gain is taxed as a capital gain, even though the depreciation deductions reduced

ordinary income. The taxpayer who has taken excessive depreciation deductions and then sells an asset, therefore, has in effect converted ordinary income into a capital gain.

The President stated that our capital gains concept should not encompass this kind of income. He indicated that this inequity should be eliminated, especially in view of the proposed investment credit for newly acquired property. He states that we should not encourage the further acquisition of such property through tax incentives as long as this loophole remains. It is also desirable to amend the law to remove the tax advantage related to depreciation deductions in order to make it feasible for the Treasury to adopt more liberal rules with respect to the estimated useful life of depreciable assets.

Your committee in general is in accord with the President's point of view although it has made a number of modifications in the proposal he presented. Your committee's bill, as recommended, in general treats as ordinary income any gain on the sale or other disposition of certain depreciable property to the extent of the depreciation deductions taken. Under your committee's provision, however, this treatment will apply to property subject to the allowance for depreciation which is either (1) personal property or (2) certain other tangible property which does not include a building or its structural components. Your committee decided not to apply this treatment to buildings or structural components of buildings at this time because testimony before your committee indicated that this treatment presents problems where there is an appreciable rise in the value of real property attributable to a rise in the general price level over a long period.

Your committee also decided that this provision should have a clearly prospective application and, therefore, the only gain which is to be treated as ordinary income is depreciation occurring in 1962 and subsequent years.

Also, because of the assurance this provision provides of recapturing excessive deductions as ordinary income, your committee has found it possible to be more lenient in determining salvage value for depreciation purposes. Under your committee's provision, in determining depreciation the salvage value of an asset may be reduced by up to 10 percent of its cost or other basis, and if this value is less than 10 percent of basis (at the time it is determined), it may be disregarded altogether. In addition, for a period of time after the new ordinary income treatment becomes applicable, taxpayers will have a new election to change their method of depreciation with respect to personal property from any declining balance or sum of the years digits method to the straight-line method. This will enable them to elect a more conservative method of depreciation if they wish to escape the possibility of ordinary income upon the sale of the assets, because of excessive depreciation deductions.

The above description has been in terms of the sale or exchange of a depreciable asset. There are, of course, other methods of disposing of an asset which also must be dealt with in this provision. In the case of a gift or a transfer at death no gain is recognized at the time of the disposition of the asset. In the case of a gift, however, the ordinary income potential of the depreciation deductions carries over into the hands of the donee. In the case of gifts to charity, although no ordinary income is recognized at the time of the gift, the charitable

contribution is reduced by the amount which would be recognized as ordinary income if the property were sold. Generally, in other cases any gain which under present law would be recognized at the time of the disposition of an asset will be treated as ordinary income to the extent of any depreciation deductions taken. In certain cases, however, in order to prevent tax avoidance it has also been found necessary to realize ordinary income on the disposition of an asset even though gain might not otherwise be recognized. This is true in certain cases where a distribution is made by a corporation or partnership. These and other provisions where ordinary income may be recognized are described in the general explanation below.

B. General explanation of provision

1. *General rule.*—The general rule (in sec. 1245) provides that ordinary income is to be recognized in the case of sales or exchanges to the extent the so-called recomputed basis, or amount realized in the sale or exchange, whichever is lesser, exceeds the basis of the property in the hands of the person making the sale or exchange. "Recomputed basis" is defined generally as equaling the adjusted basis plus the depreciation deductions previously taken. The excess of the amount realized over the adjusted basis is, of course, the amount presently recognized as capital gain. Since the rule requires that the smaller of these two amounts be treated as ordinary income, this in effect means that the ordinary income in the usual case is to be the gain realized or the sum of the depreciation deductions taken, whichever is the smaller. Where there is a disposition of an asset without a sale or exchange, gain is determined by reference to the fair market value of the asset.

Since this provision is to have prospective application only, in computing depreciation for this purpose only depreciation deductions occurring in taxable years beginning after December 31, 1961, are to be taken into account. Depreciation deductions for this purpose include not only regular depreciation deductions but also the special initial allowance deduction and any deduction for the amortization of emergency facilities. The depreciation deductions taken into account are not limited to those taken by the taxpayer, but also include deductions taken by others from whom the taxpayer acquired the property, if the basis of the property was carried over from the person from whom the taxpayer acquired it. This would not be true, where the taxpayer acquired the property from another by reason of the latter's death, since in this case the property receives a new basis at death. The general rule is that the depreciation deduction taken into account for each year is the amount allowed or allowable whichever is greater. However, a special rule provides that the depreciation deductions taken into account as to any year will be the amount "allowed" rather than the amount "allowable" if the former is smaller and the taxpayer can establish what the amount was.

The type of property receiving the ordinary income treatment described above is (1) personal property (other than livestock) and (2) other property which is tangible, not including a building or its structural components, which is an integral part of certain specified business activities or which constitutes research or storage facilities used in connection with these activities. The activities specified are manufacturing, production, or extraction, or of furnishing transporta-

tion, communications, electrical energy, gas, water, or sewage disposal services. The exclusion for "livestock" means all types of livestock except poultry.

The ordinary income treatment provided by this section will be applied upon the sale of all property the acquisition of which could have resulted in an investment credit (sec. 38 of the code as added by this bill). However, the ordinary income treatment may also apply to the disposition of property even though the acquisition of this specific property did not result in an investment credit. For example, no investment credit may have been allowed upon the acquisition of the property because its expected useful life was less than 4 years, it was to be used outside of the United States, it was to be used by tax-exempt organizations or governmental units, it was not new when acquired (and was over the \$50,000 limit), etc.

2. *Exceptions.*—Except as specifically provided in the bill, the ordinary income treatment applies any time property is disposed of. The bill, however, provides six general categories of exceptions to this rule. The first exception is for gifts. As pointed out above, however, these deductions must be taken into account by the donee, and may result in ordinary income to him, if he sells the property. In the case of depreciable property which is given to a charitable organization, although no income is realized by the donor at the time of the gift, the amount of the charitable contribution deduction he may receive is reduced by the amount which would have been treated as ordinary income had the property been sold at its fair market value (an amendment adding a new sec. 170(e)).

A second exception to the realization of ordinary income upon the disposition of depreciable personal property is provided in the case of transfers at death (except where the sale has occurred before death and the income is treated as income in respect to a decedent under sec. 691). In this case, however, there is not a carryover of the income potential in the depreciation deductions to the decedent's legatee or heir.

A third category of exceptions to the realization of ordinary income is provided in the case of a series of transactions which generally are tax free and in which the basis is carried over. However, in these transactions where there is any gain recognized, because the exchange is accompanied by "boot" (i.e., money or its equivalent) then to the extent of this gain, ordinary income may be realized (unless the depreciation deductions are smaller). The tax-free transactions referred to relate to those occurring upon the complete liquidation of a subsidiary (sec. 332); in the case of a transfer for stock or securities to a corporation controlled by the transferor (sec. 351); in the case of a transfer by a corporation which is a party to a reorganization of property in pursuance of a plan of a reorganization solely for stock or securities in another corporation also a party to the reorganization (sec. 361); and in the case of reorganizations in certain receivership and bankruptcy proceedings (sec. 371(a) and sec. 374). Also included in the same category are contributions of property to a partnership in exchange for an interest in the partnership, and distributions by a partnership in partial or complete liquidation of an interest (but in this respect see the special partnership treatment described below). Despite the above rule there would be a recognition of ordinary income where there is a contribution of depreciable property to a tax-

exempt organization (other than a tax-exempt farm cooperative) in exchange for stock or securities in the exempt organization. Recognition of ordinary income in this case is provided because a disposition of the property by the exempt organization would not ordinarily give rise to the realization of ordinary income with respect to the depreciation deductions.

Another exception is provided in the case of so-called like kind exchanges of property used for production or investment, and for involuntary conversions. In exchanges of these types, the ordinary income realized is limited to any gain recognized, plus the fair market value of property acquired in exchange for depreciable property where the latter is exchanged for nondepreciable property or other nonqualifying property. The realization of ordinary income (to the extent of the depreciation deductions) is necessary in such cases since in the case of property, other than depreciable personal property, there is no opportunity for subsequent recovery of the ordinary income element. A similar exception is provided in the case of the exchange or sale of property in obedience to Federal Communications Commission orders or orders of the Securities and Exchange Commission (secs. 1071 and 1081). In these cases also, the ordinary income realized is limited to the gain recognized, plus any unrecovered depreciation charges with respect to exchanges of depreciable personal property for other types of property.

Special rules are also provided in the case of distributions of depreciable personal property by a partnership to a partner. A distribution of depreciable personal property by a partnership to a partner to the extent that the distribution accounts for the partner's share of gain attributable to this property is not to result in ordinary income to the distributee partner at the time of the distribution. However, the ordinary income potential of depreciation deductions taken by the partnership (or by any earlier transferee from whom the partnership acquired property without realization of gain) will be carried over to the distributee partner. When he disposes of this property, the ordinary income potential of these partnership (or prepartnership) depreciation deductions will be taken into account in a manner substantially the same as that applying where the taxpayer himself took the depreciation deductions. The property distributed is given a "recomputed basis" to the partner equal to the basis of the property in the hands of the partner plus any ordinary income gain on which the partnership would have been taxed had the property been sold by it (at its fair market value) immediately before the distribution.

The rule described above applies only to the extent a partner is considered as receiving his share of the property representing ordinary income gain. An amendment made elsewhere to the code (sec. 751(c)) provides that in other cases the ordinary income element in depreciable property is to be considered as a "unrealized receivable." Thus to the extent of depreciation deductions taken (or potential gain if smaller) ordinary income will be realized in the case of the sale of a partnership interest, in the case of a distribution to a retiring or deceased partner, and in the case of distributions to a partner where he receives either more or less than his proportionate share of property reflecting this type of gain.

3. Dispositions resulting in ordinary income where no gain is presently recognized.—In a series of situations your committee found it necessary

to recognize ordinary income even though capital gain in such situations is not recognized under existing law. This was done primarily in those cases where the transferee receives another basis for the property than that of the transferor. This treatment is provided in three types of cases where a distribution is made by a corporation without the payment of a tax at the corporate level on unrealized appreciation in value: namely, where the property is distributed as a dividend (under sec. 311), where the property is distributed in a partial or complete liquidation by a corporation (sec. 336), and where in a plan of complete liquidation a corporation sells the depreciable personal property and perhaps other assets and within a 12-month period completes the liquidation of the corporation (sec. 337). Similarly, if the property is first sold by a corporation for installment notes and the gain which would be realized on such sale is delayed because of the installment method of reporting, a distribution of these notes to the shareholders in a liquidation under section 337 (12 months' liquidation) results in the recognition of the same amount of ordinary income to the corporation as would have been realized on a cash sale of such notes. The same rule is applied whenever similar installment notes are distributed by a corporation in a liquidation in which the basis of the property to the receiving shareholder is determined under section 334(b)(2) (purchase of 80 percent of the stock of one corporation by another followed by the immediate liquidation of the corporation acquired). The other situations where ordinary income may be realized under this provision, although capital gain would not otherwise occur, include the case where a distribution is made by a partnership and the partner gives up, or acquires, more than his proportionate share of this property. Other cases involve the provisions relating to the exchange of "like kind" property, involuntary conversions, sales or exchanges to effectuate FCC policy, and exchanges in obedience to orders of the FEC. In all of these cases where the property received in exchange for depreciable personal property is not itself depreciable personal property, then gain is recognized.

4. *Salvage value.*—The bill also amends the code (a new subsec. (f) in sec. 167) to provide that in computing the basis on which depreciation may be taken for personal property, salvage value may be ignored to the extent of an amount equal to 10 percent of the cost or other basis for the property. Thus, if the expected salvage value equals 8 percent of the basis of the property, the entire basis may be written off in depreciation charges by the taxpayer. If the expected salvage value is 12 percent, all but 2 percent of the basis of the property can be taken into account in computing depreciation charges. The provision applies to depreciable personal property (other than livestock) with a useful life of 3 years or more acquired after the date of enactment.

5. *Change in method of depreciation.*—Your committee recognized that some taxpayers who have been following liberal depreciation policies may desire to follow more conservative policies in order to avoid the possibility ordinary income treatment at time of sale as provided by the bill. Therefore, the bill provides that a taxpayer may elect to change his method of depreciation with respect to depreciable personal property from any declining balance or sum of the years digit method to the straight-line method. The right to make

this election will be available for a period to be specified by the Secretary of the Treasury, after the regulations on this provision have been issued.

6. *Effective date.*—This provision is to apply with respect to taxable years beginning after December 31, 1961, and ending after the date of enactment of this bill.

XVI. FOREIGN INVESTMENT COMPANIES

(Sec. 15 of the bill and secs. 1246 and 1247 of code)

A. Reasons for provision

For the small investor who desires to diversify his shareholdings through the use of domestic mutual funds, or regulated investment companies, present law provides that if a series of conditions are met, including the distribution of at least 90 percent of the earnings of the regulated investment company no tax is imposed on the investment company to the extent it distributes its earnings. Thus, if a domestic company distributes its income currently, present law provides for the imposition of a single, rather than a double, tax, and that one is imposed on the investor rather than the company.

Increasingly in recent years, however, some taxpayers have sought to avoid this tax by investing in foreign investment companies rather than domestic companies. Under present law a foreign investment company usually pays no U.S. income tax, since U.S. tax is imposed only on income derived from sources within the United States and such companies generally have no U.S. securities and, therefore, have no income from U.S. sources. The U.S. shareholders of one of these investment companies are likely to pay a U.S. tax with respect to such investments only when they sell the stock and then, of course, this gain is taxed as a capital gain rather than ordinary income. The U.S. shareholder would, of course, pay tax on any dividend income received from such a company, but most of these companies follow the announced policy of reinvesting all of their income in stocks or bonds in order to prevent the imposition of any such dividend tax by the United States.

The tax avoidance occurring in the case of these foreign investment companies is a matter with which your committee has been concerned for many years. For example, in November of 1956, in one of your committee's press releases, the tax treatment of these foreign investment companies was listed as a tax avoidance scheme needing attention. Since that time the seriousness of this problem has increased substantially. This also is a problem referred to by the President in his tax message last year. At that time the President stated:

For some years now we have witnessed substantial outflows of capital from the United States into investment companies created abroad whose principal justification lies in the tax benefits which their method of operation produces. I recommend that these tax benefits be removed and that income derived through such foreign investment companies be treated in substantially the same way as income from domestic investment companies.

It was proposed by the administration that the preferential treatment for investments in these foreign investment companies be

eliminated by requiring U.S. shareholders in such companies to pay tax currently on their share of the income derived from the foreign investment company. The provisions included by your committee in this bill achieve much the same result but without attempting to look through the foreign corporation to the American shareholders.

Your committee's bill in general terms provides that American shareholders in these foreign investment companies, when they sell or redeem their stock, are to be taxed at ordinary income rates on their share of any earnings and profits accumulated in the foreign investment company since December 31, 1962, or since the date they acquired the stock, whichever occurred more recently. However, your committee's bill also provides that this treatment can be avoided at the election of the foreign investment company if it distributes 90 percent of its taxable income other than net long-term capital gains currently and if it informs the U.S. shareholders of their share of any net long-term capital gains. However, for this treatment to apply, the U.S. shareholders must also include in income their share of capital gains whether or not distributed. The distributions of ordinary income in this case, since they are actual distributions, would, of course, in any case be reported for tax purposes by the U.S. shareholders.

B. General explanation of provisions

As indicated above, the bill provides alternative tax treatment for shareholders of foreign investment companies. Unless an election is made to the contrary, ordinary income treatment, to a limited degree, is provided at the time an investor in a foreign investment company either sells his stock or it is redeemed. However, if the companies distribute most of their taxable income and the shareholders report capital gain, whether or not distributed, then at their election the ordinary income treatment at the time of the sale of the stock is not to apply. These two alternative provisions are discussed below.

1. Ordinary income treatment on sale of stock.—The bill provides that on the sale or exchange of stock in a foreign investment company after December 31, 1962, any gain realized is to be treated as ordinary income, rather than a capital gain, to the extent of the taxpayer's share of the company's earnings and profits accumulated in years beginning after December 31, 1962. For this purpose the taxpayer's share of these earnings and profits is limited to those attributable to his stock which have been accumulated during the period he has held the stock (excluding any earnings taxed to him when the company was a foreign personal holding company or a controlled foreign corporation). Had the company been a domestic company, distributing most or all of its earnings, these same earnings would have been taxable to him. Thus, this provision is not designed as a penalty tax, but merely to accord, to the extent practicable, the same tax treatment as that provided for domestic regulated investment companies.

To give assurances that this ordinary income will not escape tax where the shareholder holds the stock until death, the bill provides that the step-up in basis, or increase in value, which would otherwise occur at date of death is not to occur with respect to the amount which would be ordinary income to the decedent had he sold the stock just before death. Thus, when the estate, heir, or legatee sells the stock, the same amount (assuming the stock has not gone down in value) will still result in ordinary income and will be subject to U.S. tax at that time. However, the estate, heir, or legatee in such a case can treat

this as "income in respect of a decedent." Thus, in computing his ordinary income tax he will be allowed a deduction for any estate tax attributable to inclusion in the decedent's estate tax base of the amount taxed as ordinary income.

Without regard to this provision, where a shareholder sells or exchanges stock in one of these foreign investment companies after holding it for not more than 6 months, the gain is short-term capital gain. Since this type of gain is treated much like ordinary income for tax purposes, the bill provides that if stock in a foreign investment company is held for 6 months or less the provision is not to apply.

A foreign investment company, for purposes of this provision is defined as a foreign corporation, either registered under the Investment Company Act of 1940 as a management or unit investment trust, or any other corporation engaged primarily in the business of investing, reinvesting or trading in securities where more than 50 percent of the voting stock (and total value of all shares) is held directly or indirectly by U.S. persons. "United States persons," a definition added to the code by the foreign trust provision in this bill (sec. 9), means a citizen or resident of the United States, a domestic partnership, a domestic corporation, and a domestic estate or trust.

To prevent avoidance of this ordinary income tax treatment through the use of tax-free (or partially tax-free) exchanges in which stock in a foreign investment company is exchanged for other stock (in a tax-free incorporation or contribution to capital under sec. 351), the bill provides that the substituted stock in such a case (where its basis is determined by reference to the basis of stock in a foreign investment company) is to be treated substantially as if it were the foreign investment company stock. Thus, upon its sale, any gain to the extent of the appropriate share of the foreign investment company's earnings and profits during the period the substituted stock was held (plus the period in which the foreign investment company stock itself was held) is to be treated as ordinary income.

The bill also contains several other provisions similarly designed to prevent the avoidance of the ordinary income treatment through indirect ownership of the foreign investment company stock through certificates in a trust, through stock in a domestic corporation, or through a partnership. In this respect it is provided first that a share of stock in a domestic corporation or a trust certificate is to be treated as foreign investment company stock to the extent it represents such stock. Secondly, it is provided that if a company is a member of an affiliated group (with a 50-percent rather than an 80-percent stock-ownership requirement), then the earnings and profits of the entire group are to be allocated under regulations prescribed by the Treasury Department in a manner to carry out the purposes of the bill. Thus, where a foreign corporation is a holding company in the sense that it holds the stock of one or more foreign investment companies, the shareholders of the holding company will not be permitted to avoid ordinary income on the sale of the foreign holding company stock merely because the earnings and profits of the investment company (or companies) have not been distributed to the holding company. Thirdly, the bill provides that the ordinary income treatment is to apply to redemptions of stock by a foreign investment company which would otherwise be treated as sale transactions because of section 302(a)

(disproportionate buy-out of a shareholder) or because of section 303 (a redemption of stock to pay death taxes). Finally, the bill deals with the sale or exchange of and also certain distributions with respect to partnership interests. The bill provides that if any of the property of the partnership were stock in a foreign investment company and would have resulted in ordinary income had it been sold by the partnership itself, then this amount is to be treated as an inventory item. Thus, the sale of the partnership interest (and distributions in certain cases) will generally result in the incurring of ordinary income treatment with respect to the foreign investment company stock underlying the partnership interest.

The bill provides that the shareholder upon sale of the stock must establish the amount of the accumulated earnings and profits of the foreign investment company and his share of these earnings during the period of his investment. If he does not do so, the entire gain will be treated as ordinary income. This information, of course, is necessary to determine the amount subject to ordinary income tax. In addition, the bill provides that every U.S. person owning 5 percent or more in stock of a foreign investment company is to furnish with respect to such a company such information as the Secretary of the Treasury deems necessary in order to properly enforce the tax provisions applicable to shareholders of these companies.

2. *Election to distribute income currently.*—Foreign investment companies which are registered with the SEC to sell stock in this country can elect to make the provision described above inapplicable under certain conditions. Any such election must be made before December 31, 1962.

For the provision referred to above to be inapplicable the electing foreign investment company must agree with respect to the current and all subsequent years to—

(1) distribute 90 percent of its taxable income to its shareholders. This is exclusive of capital gains.³ Also, such a corporation can elect to treat as distributed during the year distributions made in the first 2½ months after the end of the year.

(2) designate in written notices mailed to its shareholders their share of the excess of net long-term capital gains over net short-term capital losses, and the portion, if any, which the corporation has distributed. These notices must be mailed to the shareholders within 30 days after the close of the taxable year.

(3) provide such information as the Treasury Department considers necessary to carry out the purposes of this provision.

In addition to the corporation fulfilling these requirements, however, the individual shareholder (who is a U.S. person), if he is to avoid the ordinary income treatment upon the sale of his stock, also must include in his income for tax purposes the excess of the net long-term capital gain over the net short-term capital loss, which the company in its notice to him designated as being his share of the company's capital gains. If the shareholder does not do so for any year, unless this failure was due to reasonable cause and not to willful neglect, the election provided by this provision will not apply when he sells or otherwise disposes of his stock. Thus, although other shareholders

³ For this purpose, as in the case of domestic regulated investment companies, no net operating loss carry-over is allowed and no organizational expense deduction is allowed.

might continue to qualify in such a case, the shareholder who did not report this capital gain income, upon his sale of the stock will have ordinary income (limited as indicated above). It is not made a condition of qualification that the shareholder in such a case report his share of the ordinary income of the corporation. However, since at least 90 percent of his share of this income will actually be distributed to him, it must in fact be reported by him, in the same manner as any other dividend income which he may receive from foreign sources.

The bill provides that these capital gains, reported by the shareholders, although not actually distributed, are to result in a decrease in earnings and profits of the corporation for the shareholders who report them and also that the basis that they had for the foreign investment company stock is to be increased by this amount.

The election described above with respect to the foreign investment company continues until the company fails to comply with the three conditions set forth above, unless the company becomes a foreign personal holding company, or no longer is a foreign investment company.

To prevent the use of the capital gains designating provision as a means of obtaining short-term capital losses which may be short-term capital gains or under certain circumstances ordinary income, merely at the cost of reporting a capital gain under this provision, the bill provides that if the shareholder has held the stock for less than 6 months, then any loss realized on the sale of the stock within that 6-month period is to be treated as if it were a long-term rather than short-term capital loss.

3. *Effective date.*—The amendments made by this provision apply to taxable years beginning after December 31, 1962.

XVII. GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS

(Sec. 16 of bill and sec. 1248 of code)

A. Reasons for provision

Under existing law, through an ordinary taxable liquidation or sale or exchange, it is possible to bring earnings accumulated by a foreign corporation back to this country merely by paying a capital gains tax on any gain. Theoretically it is also possible to bring earnings accumulated by a foreign corporation back to the United States without payment of income tax through the use of a tax-free reorganization (under sec. 368) or through the use of a tax-free liquidation (under sec. 332). However, to do so the Commissioner of Internal Revenue must give clearance by determining in advance that the transaction "is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes." Generally the Commissioner has been unwilling to grant such approval where there is an appreciable amount of earnings and profits accumulated in a foreign corporation.

Your committee has as one of its objectives in the foreign income area the imposition of the full U.S. tax when income earned abroad is repatriated. These objectives are set forth more fully in connection with the discussion on controlled foreign corporations in section 13 of the bill. Full U.S. taxation will occur in the case of the ordinary,

taxable liquidations or sales or exchanges only if the earnings and profits are in effect taxed as dividends (to the extent of any gain) at the time the funds are brought back to the United States. This objective is accomplished by this section of your committee's bill.

B. General explanation of provision

The new provision contains special provisions dealing with redemptions and liquidations, as well as with sales and other exchanges of certain stock of controlled foreign corporations (as defined in sec. 13 on controlled foreign corporations). These apply if the foreign corporation, the stock of which is sold or exchanged, was a controlled foreign corporation at any time during the 5-year period ending on the date of the sale or exchange. However, they apply only to any U.S. person who owned 10 percent or more of the total combined voting power of the foreign corporation at any time during the 5-year period ending on the date of the sale or exchange. (In computing the 10-percent ownership test, the ownership rules applicable in the case of controlled foreign corporations are used.)

The bill provides that if a controlled foreign corporation redeems its stock, and if the redemption is not already a dividend (under sec. 302), then the gain to the stockholder from the exchange of his stock is to be treated as a dividend to the extent of his share of the earnings and profits of the foreign corporation. This provision applies in the case of a partial liquidation, a total liquidation or a buy-out of all of a shareholder's stock. If the shareholder is a domestic corporation, the foreign tax credit is allowed in the same manner as in the case of dividends generally.

In the case of a sale or exchange of stock of a controlled foreign corporation by a shareholder, the gain of the seller is considered by the bill to be ordinary income to the extent of his share of the earnings and profits of the foreign corporation accumulated during the period he held the stock.

The operation of the above two provisions may be illustrated by the following examples. Assume a U.S. corporation owns all of the stock of a foreign corporation and that the foreign subsidiary is liquidated. Assume further that the transaction is a taxable one because the commissioner refused to grant clearance under section 367. Under the bill this liquidation remains a taxable one. However, while under existing law all of the gain recognized to the domestic corporation probably would be capital gain, under the bill the domestic corporation is viewed as having received a dividend, to the extent of the earnings and profits of the foreign corporation at the time of the liquidation, or to the extent of the gain recognized, if that is smaller. Thus, if the basis of all of the subsidiary's stock is \$100,000 and the fair market value of all of the assets received by the parent on the liquidation is \$200,000, the gain which would be recognized under present law is \$100,000. If the foreign subsidiary had current and accumulated earnings and profits of \$50,000 at the time of the liquidation, under the bill the parent is treated as having received a dividend of \$50,000 and a capital gain of \$50,000. Any credit for foreign taxes paid would apply to the amount treated as a dividend in the same manner as in the case of an actual dividend of \$50,000.

In a second example, assume a domestic corporation proposes to acquire substantially all of the assets of a foreign corporation, solely

for voting stock of the domestic corporation. Immediately after this acquisition the foreign corporation is to be liquidated and its shareholders given stock of the domestic corporation in exchange for their stock in the foreign corporation. Assume also that clearance under section 367 is requested from the Commissioner and denied. The acquisition of the assets of the foreign corporation for the stock of the domestic one is not a tax-free acquisition (under sec. 368). Also, the distribution of stock of the domestic corporation to the shareholders of the foreign corporation is an ordinary taxable liquidation. Under the bill if any shareholder owned more than 10 percent of the stock of the foreign corporation during the preceding 5 years, and if the foreign corporation was a controlled foreign corporation at any time during that period, the provisions of the bill are to apply to such a shareholder. Thus, the shareholder will be treated as having received a dividend to the extent of the accumulated earnings and profits of the foreign corporation at the time of the liquidation or to the extent of his gain, whichever is smaller.

The section does not apply to redemptions to pay death taxes (sec. 303) nor does it apply to gain recognized because of boot on reorganization exchanges (sec. 356).

The section also does not apply to the extent that any amount of gain is under other code provisions treated as a dividend, a gain from the sale of an asset which is not a capital asset, or a gain from the sale of an asset held for not more than 6 months.

The bill provides that if there are any earnings and profits accumulated and not distributed which have already been included in gross income (under the controlled foreign corporation provision as added by sec. 13 of the bill) the amount which has been so included is not to be included in the same shareholder's income a second time.

The limitations described above on the amount to be treated as dividend or ordinary income are not to apply unless the taxpayer establishes the earnings and profits of the foreign corporation to be taken into account. If this is not established, any gain from a sale, exchange or redemption is to be considered a dividend, or ordinary income, as the case may be.

The section is made effective with respect to sales or exchanges occurring after the date of enactment of the bill.

XVIII. TAX TREATMENT OF COOPERATIVES AND PATRONS

(Sec. 17 of the bill and secs. 1381 to 1388 of the code)

A. Reasons for provision

In 1951 Congress passed legislation which, taken together with prior Treasury rulings, it generally was thought insured that earnings of cooperatives would be current taxable (to the extent they reflected business activity) either to the cooperatives or to the patrons. However, certain court decisions, notably, the *Long Poultry Farm* and *B. A. Carpenter* cases, held that noncash allocations of patronage dividends generally were not taxable to the patron, although they were deductible by the cooperative.

The President recommended that what was thought to be the law in 1951 be provided specifically in the statute. Under the recommendation cooperatives would be allowed to deduct amounts allocated

in cash or scrip as patronage dividends and patrons would be currently taxable on the patronage dividends allocated to them arising out of business activities.

Your committee's bill adopts an approach which in substance is substantially the same as that recommended by the President. It provides that the cooperative is not required to take patronage dividends paid in money, qualified allocations, or other property except the nonqualified allocations into account in determining taxable income. A deduction is also provided for the nonqualified allocations when they are redeemed. For the patron, the bill provides that these same amounts (to the extent not attributable to purchases of personal living or family items) are to be included in their income for tax purposes in the year received (or in the case of a nonqualified allocation, when redeemed).

Qualified allocations for this purpose are defined by the bill as including first, allocations which the patron can redeem in cash at their stated dollar amount at any time in the first 90 days after they are issued. Second, qualified allocations also include allocations which the patron has consented to take into account at their face amount as income (unless the patronage was with respect to personal living expenses or capital items). In the case of members, consent may be given by being a member of the cooperative if there is a provision in the bylaws requiring all members to agree to take the allocations into account. In the case of nonmembers (and members if the cooperative prefers) this consent can be provided by the patron signing an agreement to do so. Your committee believed that, since in the case of either the 90-day or consent allocation the patrons have constructively received the dividend and reinvested it, it is clear (where the patronage dividend arises from business activity) that it constitutes income to the patron and is properly taxable to him.

This amendment is effective for taxable years beginning after December 31, 1962, in the case of the cooperatives and in the case of patrons is effective with respect to amounts paid by the cooperatives in taxable years of the cooperative beginning after that date. Existing law will continue to apply with respect to allocations (including their redemption after the specified date) issued in earlier taxable years to which the new provisions do not apply.

B. General explanation of provision

This provision deals both with the tax treatment of cooperatives and the tax treatment of patrons.

1. *Cooperatives covered by provision.*—The tax treatment outlined here applies to the so-called tax-exempt farmers' cooperatives, to other farm cooperatives, to consumer cooperatives, and also to other corporations operating on a cooperative basis. The provision does not, however, apply to exempt mutual ditch, irrigation, or REA cooperatives, to mutual savings banks, building and loan associations, etc., or to mutual insurance companies. It also does not apply to presently taxable organizations which are engaged in furnishing electric energy, or providing telephone service, to persons in rural areas. These will continue to be treated the same as under present law.

2. *Patronage dividends.*—The bill provides that in determining the taxable income of a cooperative there is not to be taken into account patronage dividends which are paid in money, qualified allocations,

or other property (except nonqualified allocations).⁴ A deduction also is allowed for nonqualified allocations when they are redeemed in cash or other property (except allocations). If there is no taxable income in the year of the redemption against which to take this deduction for redeemed nonqualified allocations, the cooperative may obtain a credit or refund of the tax it paid in the prior year on the earnings represented by the allocations. This gives the cooperative assurance that the deduction for the redeemed patronage dividend will not be wasted.

Under present law patronage dividends paid by taxable cooperatives result in a reduction in the cooperative's taxable income only with respect to amounts paid during the taxable year in which the patronage occurred, or within the period in the next year elapsing before the prior year's income tax return is required to be filed (including any extensions of time granted). This is generally a 2½-month period. In the case of exempt farmers' cooperatives, these patronage dividends presently are taken into account as a reduction in taxable income if paid at any time before the 15th day of the 9th month following the close of the year, but there is no requirement that the patronage must have occurred in that year. Your committee's bill extends the time period in which taxable cooperatives can pay patronage dividends, and still take them into account in reducing taxable income, until this 15th day of the 9th month after the end of the year in question. This conforms the treatment already accorded exempt cooperatives. This period of time is also made available to both "taxable" and "exempt" cooperatives for payment of the other deductible amounts described below. In addition, exempt cooperatives are now required to pay the patronage dividends within 8½ months after the year when the patronage occurred. In the case of pooling arrangements extending over more than 1 year, the patronage is considered as occurring in the year in which the pool closes.

3. *Qualified allocation*.—Allocations, or more exactly written notices of allocation, are patronage dividends paid in the form of capital stock, revolving fund certificates, certificates of indebtedness, or other written notice which indicates to the recipient the dollar amount allocated to him by the cooperative. For the allocation to be a qualified allocation (and therefore taken into account as a reduction in income for the year it is issued rather than the year it is redeemed) one of two conditions must be met. First, it may be an allocation where the patron for a 90-day period beginning with the date the allocation is paid has the opportunity to redeem the allocation in cash for the stated amount of the patronage dividend. However, for such an allocation to be qualified, the patron must receive a written notice of this right to redemption at the same time he is notified of the allocation.

The second alternative qualifying rule provides that the allocation is qualified where the patron gives consent to have it treated as a distribution to him which he will take into his income for tax purposes (if the patronage arises from a business activity). This consent may take either of two forms. For members of the cooperative this consent may be given by becoming or continuing as a member after the cooperative has adopted a provision in the bylaws providing that membership in the cooperative constitutes such consent. In this case,

⁴ For purposes of the other internal revenue laws these patronage dividends are treated in the same manner as items of gross income for which deductions were allowed.

however, the member (or prospective member) must be furnished a written notice that the bylaws contain such a provision and must be furnished a copy of this provision. Such a consent cannot be revoked as long as the patron is a member. An alternative form of consent for members of the cooperative, and the only form of consent for nonmembers, is a written statement signed by the patron in which he gives the consent referred to above. This form of the consent must originally be given by the patron to the cooperative before the end of the year in which the patronage occurs. Once this consent is given it is valid for all subsequent years until the patron revokes it. A revocation becomes effective for the first of the next year (in the case of pooling arrangements it is effective only with respect to new pools). By either of these forms of consent the patron has in effect constructively received the patronage dividend and reinvested it in the cooperative.

4. *Additional deduction for "exempt" farmers' cooperative.*—In addition to reducing taxable income for qualifying patronage dividends, the bill permits the so-called exempt farmers' cooperative as under present law a deduction for amounts paid out as dividends on its capital stock. Such cooperatives also receive deductions for amounts paid in money, qualified allocations, or other property (except nonqualified allocations) to its patrons on a patronage basis where the earnings involved are derived from business done for the U.S. Government or from sources other than patronage (such as investment income).

This deduction, except that in the case of allocations it is limited to qualified allocations, is the same as that provided by existing law except that under your committee's bill, the amounts must now be paid within 8½ months after the year in which the earnings were derived. Amounts paid in the redemption of nonqualified allocations also are available to these exempt cooperatives as deductions under the bill.

5. *Treatment of patron.*—With the exceptions referred to below, under the bill the patron is required to take into income the patronage dividends (and the nonpatronage distributions described above) paid in money, qualified allocations, or other property and the amount he is required to take into his income is the same as that which may be currently deductible to the cooperative; namely, in the case of qualified allocations, their stated face amount and in the case of other property (except nonqualified allocations), its fair market value. The patron also is required to take into income any nonqualified allocations which are redeemed. These amounts are taken into the patron's income in the year in which they are received by him, or in the latter case in the year in which the redemption occurs.

Generally, the effect of the treatment specified above for patrons taken together with that also outlined above for cooperatives, is to obtain a single current tax with respect to the income of the cooperative, either at the level of the cooperative or at the level of the patron. However, this rule will not apply in the case of patronage dividends paid with respect to purchases of personal, living, or family items. In such cases, there is to be no inclusion in the income of the patron with respect to the patronage dividends. This is in accord with the concept that patronage dividends to the extent they are paid in money, qualified allocations, or other property (other than nonqualified

allocations) represent price adjustments. Therefore, the patronage dividends in these cases represent downward price adjustments of personal, living, or family items and should no more lead to taxable income than bargain purchases of such items elsewhere.

An exception to the rule for inclusion of the patronage dividends in income is also made for patronage dividends attributable to purchases of depreciable property or capital assets. In such cases the patron is not required to take the dividend into income since it in effect represents an adjustment in the price paid for these articles and therefore is reflected in their basis. However, the lower basis for the property in the case of depreciable property will mean smaller depreciation deductions or in the case of capital assets (and depreciable assets) will result in a larger gain upon sale.

6. *Returns of cooperatives.*—Because tax-exempt cooperatives under present law are given until 8½ months after the end of the year to allocate, or pay, patronage dividends, they also have been given the same period of time in which to file their tax returns. This additional time is necessary since whether or not there is an allocation or payment of the dividends, determines the size of the taxable income of the cooperative.

Allowing taxable cooperatives this same time in which to make cash and qualified allocations of patronage dividend distributions, and to redeem nonqualified allocations, has presented the same filing problem in the case of their returns as well. Therefore, the bill provides that the tax return filing date for cooperatives generally is to be 8½ months after the end of their taxable year. However, to prevent an organization allocating relatively little of its income on a patronage basis from obtaining this postponement in the filing date for its return, the bill limits this postponement to those organizations which are either exempt cooperatives or (1) are under an obligation to allocate, or pay, at least 50 percent of their net patronage earnings in patronage dividends or (2) actually allocated, or paid, at least that percentage of their earnings in patronage dividends during the last year in which they had any such earnings.

A second change made in the case of returns of cooperatives relates to information returns. Present law requires the Treasury Department to obtain information returns from cooperatives at least with respect to patronage dividends of \$100 or more. With a system of withholding on patronage dividends, as is provided by section 19 of this bill, it is no longer clear that it is necessary to retain the \$100 floor. In view of this, the bill amends the information return provision (sec. 6044) to permit the Treasury Department to raise this floor or completely remove any return requirements.

7. *Effective date.*—Generally, the bill applies to taxable years of the cooperatives beginning after December 31, 1962. For the patrons these provisions are to apply with respect to amounts received from a cooperative if the amount which is paid by the cooperative occurs with respect to patronage which at the cooperative level is also subject to the new rules. Existing law continues to apply with respect to patronage dividends paid before the date specified above (or after that date with respect to patronage in a prior year) and also with respect to redemptions of patronage dividends after that date if the scrip involved was actually issued with respect to an earlier period.

XIX. INCLUSION OF FOREIGN REAL PROPERTY IN BASE FOR ESTATE TAX PURPOSES

(Sec. 18 of bill and secs. 2031, 2033-2038, 2040 and 2041 of the code)

A. Reasons for provision

Under present law real estate situated outside of the United States is excluded from the gross estate and therefore exempt from the estate tax. This is an exception to the general rule that the gross estate of decedents who are citizens or residents of the United States include their entire property wherever situated. The exclusion of real property located outside of the United States from the estate tax base has been specifically provided for in the code since 1934. Before that time the exclusion was granted under an opinion of the Attorney General issued in 1918. No such exclusion exists under the gift tax.

In 1951 Congress adopted legislation providing a credit for estate and inheritance taxes paid to foreign countries. Before that time the exclusion of real property from the estate tax base could be justified on the grounds that the foreign country was likely to impose a tax on real property located within its jurisdiction upon the death of a foreign owner. However, with the provision for the tax credit in 1951, reducing the possibility of double taxation, the exclusion of foreign real property no longer appears appropriate.

The President in his tax program recommended that this exemption be eliminated on the grounds that in recent years this has been a subject of abuse. It was stated that primarily because of this tax advantage, U.S. citizens and residents have been induced to make investments in foreign real estate in countries with either no, or very low estate or inheritance tax rates.

In view of these considerations your committee has adopted a provision eliminating the exclusion of real property located outside of the United States from the estate tax base.

B. General explanation of provision

Under present law, real property situated outside the United States is excluded in determining the value of a decedent's gross estate for estate tax purposes. This section of the bill amends various sections of the code specifically to include such real property in the gross estate of decedents who are citizens or residents of the United States. The property is included at its fair market value either at the date of death or at the optional valuation date.

In the case of decedents dying after July 1, 1964, the bill provides that all real property located outside of the United States is to be included in their gross estate. However, some real property may also be included in a decedent's gross estate under the bill in the case of those who die after the date of enactment of the bill but before July 1, 1964. For decedents dying in this period, real property located outside of the United States is to be included in their gross estate if it was acquired on or after February 1, 1962, the date your committee announced its action on this provision. Thus, for those already owning real property outside of the United States before action was taken on this matter by your committee, time is provided for the orderly disposition of the property, or for rearrangement of estate plans—namely, until July 1, 1964—without imposing any estate tax consequences. However, your committee did not believe it appro-

appropriate to provide any similar grace period for those who acquired foreign real estate after the announcement of your committee's decision.

Capital additions or improvements to real property, to the extent they materially increase the value of the property and to the extent they are attributable to construction, reconstruction or erection on or after February 1, 1962, are treated in the same manner as real property acquired after that date. Thus, they are included in the gross estates of decedents dying after the date of enactment of the bill even though dying before July 1, 1964.

XX. WITHHOLDING OF INCOME TAX ON INTEREST, DIVIDENDS, AND PATRONAGE DIVIDENDS

(Sec. 19 of the bill and secs. 3451-3490 and sec. 39 of the code)

A. Reasons for provision

About \$15 billion in dividends and interest were reported by individuals on tax returns in 1959, the latest year for which complete Treasury data are available. In addition, there were about \$3.7 billion in dividends and interest that should have been reported in that year but were not. Most of this amount was subject to tax and the Treasury Department estimates that this underreporting resulted in a revenue loss of about \$800 million in taxes for the year. Withholding will result in the collection of about \$650 million of this amount and it is believed that almost all of the remaining gap will be accounted for when the automatic data processing system is fully developed. Your committee believes this provision also will make a real contribution toward the collection of the remaining \$150 million of uncollected tax on dividends and interest.

Not only is the revenue loss in this case of major importance, but as the President pointed out in his tax message to Congress last year with respect to this underreporting:

This is patently unfair to those who must, as a result, bear a larger share of the tax burden. Recipients of dividends and interest should pay their tax no less than those who receive wage and salary income, and the tax should be paid just as promptly. Large continued avoidance of tax on the part of some has a steadily demoralizing effect on the compliance of others.

Although educational programs have been used in attempting to cut down this underreporting there is no evidence that these programs have had any appreciable effect, nor can it properly be said that automatic data processing, even when fully developed several years from now, will be an adequate substitute for withholding. As indicated to your committee by the Treasury Department and Internal Revenue Service, withholding and ADP are designed to complement each other. Withholding collects the tax in the first bracket where the amount of underreporting per case are small, but, because of the large number involved, add up to a large proportion of the \$850 million gap. Withholding in this area eliminates the necessity of using auditors or correspondence to actually collect these small amounts, while even where the ADP system would be successful in tracing them down a collection

effort still would be necessary to collect these small amounts. Secondly, withholding makes it unnecessary to drastically lower information return requirements with respect to interest and third, it frees ADP for more intensive use in examining returns above the first bracket where, per case, the underreporting, not only in the case of dividends and interest but in the case of other income as well, is substantially greater. The Treasury Department has estimated that while ADP would result in the collection of \$200 million additional revenue in the case of dividends and interest at an administrative cost of \$27 million, withholding will result in a revenue increase of \$650 million at only an administrative cost of \$19 million.

The system of withholding provided by your committee while, of course, it does not completely eliminate administrative problems for dividends and interest recipients and payors nevertheless is designed to minimize these problems, particularly in the case of the recipients.

First, in the case of recipients—

(1) An exemption system in the case of dividends, most forms of interest and patronage dividends means that there would be no withholding for individuals owing no income tax.

(2) In the case of individuals where the withholding is large relative to the tax liability, quarterly refunds which can be obtained during the year give assurance that even these taxpayers will not be out-of-pocket the overwithheld money any appreciable period of time. Moreover, the system is designed to minimize the paperwork for them.

(3) Permitting corporations to claim credits for the tax withheld on them against their withholding on their own dividend or bond interest payments, plus permitting them on a quarterly basis to obtain refunds of any excess should eliminate almost all effects of withholding in their cases.

(4) In the case of tax-exempt organizations and governmental units, permitting the claiming of credits for tax withheld on them against the withholding they already perform on wage and salary payments to their own employees, plus exemptions or exemption certificates in certain cases, plus the provision for quarterly refunds should eliminate or minimize any withholding effects in their cases.

Second, by providing for withholding at a uniform 20 percent without any requirements for supplying receipts should ease problems both for the payors and the recipients. The even 20-percent rate will minimize problems with fractions in dividend and interest computations and make it easy for the individual to include in his return, and claim credit for, the amount withheld, merely by increasing the 80 percent remaining after withholding by 25 percent.

Third, the retention of a uniform withholding rate applicable in all cases, except where the exemption certificates are filed, should hold to a minimum the actual administrative problems of the payors since they will be able to send a single check to the Government equal to 20 percent of their gross dividend or interest payments (apart from those with respect to which exemption certificates were filed).

Fourth, dividend and interest payors are compensated for any additional administrative costs they may have by being permitted to retain the use of the withheld amounts of tax until 1 month after the end of the quarter of their taxable year to which the interest relates.

B. General explanation of provisions

The bill provides that payors of interest, dividends, and patronage dividends are to withhold one-fifth or 20 percent of the payment they would otherwise make to the interest, dividend, or patronage dividend recipient, with certain exceptions noted above. This withheld amount is to be paid over to the Government by the payor (sec. 3481) by the last day of the first month after the end of each quarter of the payor's taxable year (April 30, July 31, October 31, and January 31 for calendar year taxpayers).

The recipient of the interest, dividend, or patronage dividend payment when he files his own income tax return can claim credit for the payment made by the payor on his behalf. This withholding system does not require the attachment of any receipt by the recipient of the payment to his tax return (sec. 3489 provides a presumption that amounts have been withheld). It also does not require the payor to send the income recipient any receipt. Instead, it is presumed that, initially at least, payors will indicate in some communication to the recipient of the payment that the payment is "net," that is, reduced by one-fifth for the amount withheld for the Government.

It is contemplated that the recipient of the payment on his tax return first will report the net interest, dividend, or patronage dividend payment received. He will then be requested to add to this amount one-fourth of the amount received, representing the amount withheld. This is what is referred to as "grossing up" the interest or dividend payment. Thus, for example, if an individual were entitled to \$100 of dividends before withholding, one-fifth of this amount, or \$20 would be withheld by the payor and remitted to the Government. The remaining \$80 would be the net dividend payment received by the recipient. This is the amount he would initially report on his income tax return. He would be asked to add to this one-fourth of this amount, or \$20, bringing the total back to the full \$100 dividend payment. He would then compute his income tax in the usual manner. Finally, the tax otherwise owed would be reduced by the amount withheld with respect to this dividend payment, namely, \$20.

Under the bill, provision is made for exemptions from withholding in certain cases and also for quick refunds where no tax is owed or there is overwithholding. In addition, no withholding is provided in the case of certain types of interest and other payments.

The withholding provisions generally are to be effective with respect to interest and dividend payments made after January 1, 1963. In the case of patronage dividends, the withholding provisions will apply to payments with respect to patronage occurring in the first taxable year of the cooperative beginning after January 1, 1963.

1. *General definitions of interest, dividends and patronage dividends.*—The bill defines interest, dividends, and patronage dividends, to which withholding is to apply, in fairly broad terms and then specifies certain exceptions. The definitions are described here; the discussion of the exceptions then follows.

The definition of interest provided by the bill for the most part is limited to payments made by corporations where the holder of the indebtedness is likely to be an individual (although not necessarily actually so in any given case). In addition, where non-interest-bearing obligations are issued on a discount basis, no attempt is made to withhold on the payments received at the time of the redemption

of the obligation (except in the case of savings bonds). Withholding is not provided where discounts are involved because of differences in the tax treatment of original issue discount where the obligation is held to maturity by the initial holder and where it is acquired before that time by a subsequent purchaser.

In more specific terms, the bill includes within the definition of interest, to which withholding is applied, seven different categories of interest:

(1) Interest on evidences of indebtedness (such as bonds, debentures, notes, and certificates) issued by a corporation with interest coupons or in registered form. In addition, there is included interest on other types of indebtedness issued by a corporation where the instrument is of a type generally offered by corporations to the public, but only to the extent so provided by regulations issued by the Treasury Department. This will not include interest on mortgage paper generally, since mortgages usually are not of a type offered by corporations to the public.

(2) Bank account interest.

(3) So-called dividend payments made by mutual savings banks, savings and loan associations, building and loan associations, cooperative banks, homestead associations, credit unions, etc.

(4) Interest on amounts held by insurance companies under an agreement to pay interest. This does not include policyholder dividends but does include interest on accumulations of such dividends as well as other amounts held at interest by these companies. The withholding occurs at the time the amounts otherwise are required by law to be reported as income.

(5) Interest on deposits with stockbrokers.

(6) Interest on obligations of the United States. This does not include any obligations issued at a discount, such as Treasury bills (but see category 7 below).

(7) Interest on non-interest-bearing obligations of the United States issued at a discount and having a maturity of more than 1 year from the date of issue. This is primarily interest on series E savings bonds.

The definition of a dividend for purposes of the withholding tax is the same as that provided by the code for other purposes (as defined in sec. 316). However, in addition, "dividends" are defined as including payments made by stockbrokers as substitutes for dividends. Thus, if an individual has sold stock short, his broker may have borrowed stock for him from another person to cover his short sale. If a dividend becomes payable during the period of the loan of the stock, in such a case the stockbroker must make a payment to the person from whom the stock was borrowed as a substitute for the dividend he would otherwise receive (and obtain reimbursement for this payment from the person to whom the loan of the stock was made). Under the bill such a substitute payment by a stockbroker is treated as if it were a dividend for purposes of withholding.

In the case of patronage dividends withholding will apply to those paid in money, in qualified allocations, and in other property except nonqualified allocations. (See XVIII-B-3 for discussion of qualified allocations.) In addition, in the case of the so-called exempt farmer's cooperative, withholding is to apply to amounts not representing

patronage dividends where the amounts are paid to patrons in money, qualified allocations, or other property (except nonqualified allocations) if the payment is made on a patronage basis and the earnings involved are derived from business done with the United States or from sources other than patronage (such as investment income). Withholding does not, however, apply to so-called progress payments made by marketing cooperatives.

2. *General exceptions where withholding does not apply.*—The bill provides certain exceptions to the definitions of interest, dividends and patronage dividends subject to withholding. In the case of all three categories of payments the bill provides that no withholding is to occur with respect to amounts paid by one corporation to another where both are members of the same affiliated group and where a consolidated return was filed for income tax purposes in the past year. In such cases these intercompany transactions are “washed out” for tax purposes.

A second group of payments to which withholding is not to apply in the case of any of these three types of payments are those made to nonresident aliens and foreign corporations where there already is a special form of withholding by the payor under present law, or where there would be but for the fact that the income is not considered as income from sources within the United States.

A third group of payments to which withholding will not apply are interest, dividend, or patronage dividends paid by foreign corporations not engaged in trade or business within the United States. The corporation in such cases is not subject to U.S. jurisdiction although income received from it by a U.S. citizen or resident may be subject to U.S. tax.

In the case of interest payments, exemptions from withholding are also provided for—

(1) Interest on tax-exempt State and local obligations since these are not subject to income tax.

(2) Amounts paid by a foreign government, international organization, nonresident alien not engaged in a trade or business here, or a partnership not engaged in a trade or business here and composed in whole or in part of nonresident aliens. (An exemption for foreign corporations not in business here was previously noted.) In such cases the payor is not subject to U.S. jurisdiction although income received from it may be subject to U.S. tax in the hands of a U.S. citizen or resident.

(3) Bank account interest paid to foreign corporations, nonresident aliens, and foreign partnerships. In this case the income is not subject to U.S. tax.

(4) Amounts paid with respect to tax-free covenant bonds. The payor in such a case is required to pay the tax.

(5) Amounts paid with respect to deposits in school savings accounts to the extent provided by regulations. In such cases the exemption in general will be limited to children, the great bulk of whom would in any case owe no income tax.

(6) Bank account, mutual thrift and Government series E bond interest paid to States, foreign governments, and international organizations. In these cases the interest income is not subject to tax by the United States.

(7) Amounts paid by a U.S. agency or instrumentality to another U.S. agency or instrumentality if the Secretary of the Treasury determines that the withholding in this case represents an unnecessary burden. In this case also no tax would be due.

In the case of dividends, the additional exceptions where withholding is not to apply are as follows:

(1) Amounts paid in stock or stock rights where the distribution is not includible in the income of the recipient.

(2) Any distribution where the recipient treats the amount received as a capital gain or recognizes no gain or loss.

(3) Amounts which, even though includible in the income of the recipient, are treated as redemptions of stock (sec. 302), dispositions of section 306 stock, additional consideration in connection with certain reorganizations (sec. 356), or distributions pursuant to an SEC order (sec. 1081(e)(2)).

(4) Undistributed amounts treated as dividends of corporations electing subchapter S treatment (treatment similar to partnerships).

(5) Amounts paid under a lease entered into before 1954 where the shareholders of the lessor corporation are entitled to the amounts without deduction for any U.S. tax.

In the case of patronage dividends, in addition to the exceptions previously noted, where the Secretary of the Treasury determines that a cooperative is primarily engaged in selling at retail goods or services which are generally for personal, living, or family use, an exemption from withholding may be provided. Patronage dividends in this case are not includible in the income of the recipient and, therefore, need not be subject to withholding.

3. Exemption certificates and intra-annual refunds and credits for individuals.—To prevent hardships in the case of those who owe no tax on their interest, dividends, or patronage dividend payments, or who are subject to overwithholding, the bill contains a series of provisions providing for exemption from withholding or refunds or credits of the withholding tax. Under this heading there are presented those provisions applicable in the case of individuals. This is followed by discussions of the provisions applicable to governmental units and tax-exempt organizations, to corporations generally, and finally to nonresident aliens.

In the case of individuals, interest, dividend, and patronage dividend withholding is not to apply where the individual files an exemption certificate with the payor of the dividend or interest, certifying that he reasonably believes he will not be liable for the payment of any income tax for the year in question (sec. 3483).

For those under age 18, the exemption certificates can be filed whether or not the individual expects to have any tax liability and once filed, need not be filed again. Instead the payors will remove their names from their exemption lists at the first of the year in which they become 18. Permanent exemption certificates are feasible in the case of children because of the relatively small proportion of them owing any tax.

The exemption certificates generally must be filed with the dividend or interest payor once a year. They may be filed with respect to bank account interest, patronage dividends, and certain dividend payments, but not with respect to corporate or Government bond

interest (other than savings bonds referred to below). An exception is necessary for corporate and Government bond interest because of the difficulty of making exemption certificates work where these bonds are transferred from one holder to another between interest payment dates, where one such holder might be exempt and the other not. Because of problems in handling the exemption certificates, for dividends to be eligible for exemption certification the stock must not be held in the name of a stockbroker or other nominee.

The exemption certificates apply in the case of series E savings bonds but instead of filing one exemption certificate a year in such cases, a separate exemption certificate is required to be filed with respect to each transaction in which these bonds are cashed in. This is necessary since these bonds may be cashed at different places.

The bill provides that anyone who willfully files an exemption certificate, knowing the certification to be fraudulent or false, is to be fined not more than \$500 or imprisoned for not more than 1 year, or both.

In addition to the exemption certificates described above applicable where there is no tax liability, the bill provides for quarterly refunds payable during the year, where there is tax liability but the withholding is expected to be excessive. In the case of wage withholding it is possible for the payor to take into account directly the personal exemptions of the taxpayer. However, in the case of dividend, interest, and patronage dividend withholding, both because there is a much greater chance of multiple payors and also because of the greater likelihood of the purchase or sale of stock during the year, no system of having the payor take exemptions into account appears feasible. However, much the same effect is achieved by a quarterly refund system. Quarterly refunds are available to single persons expecting a gross income of less than \$5,000 and married individuals and heads of households expecting a gross income of less than \$10,000 a year. These quarterly refunds in no case are to be available for dependent children. (For treatment of refunds in their cases, see discussion below.)

Taxpayers whose gross income is expected to be below the specified amount may file one refund claim each quarter (at any time during the quarter). This claim may request a refund for any withholding on interest, dividends, or patronage dividends up to the amount of the taxpayer's "refund allowance." His "refund allowance" is 22 percent of—

- (1) his expected deductions for personal exemptions, plus
- (2) his expected retirement income, less
- (3) any other taxable income he expects to receive which is not subject to dividend or interest withholding.

A subtraction must also be made for any refunds received in earlier quarters during the year. In effect this grants the taxpayer an exemption from withholding for his personal exemptions, retirement income credit, and (through a 22-percent factor rather than a 20-percent factor) his standard deduction similar to the exemption provided through employers for wage withholding.

Actually the taxpayer generally will need to compute his claim for refund only in the first quarter. In the second and third quarters it is expected that the Internal Revenue Service will automatically mail him partially completed refund claims refund, based upon the infor-

mation the taxpayer previously submitted. This procedure can be followed in all cases where the taxpayer indicates his income status has not changed significantly from his prior expectations. For the fourth quarter the refund is to be claimed on the regular tax return of the individual which he may file immediately after the end of the year.

To minimize small adjustments, the bill provides that the intra-annual refund claims may be filed only for amounts of \$10 or over. However, where the excess withholding for one quarter may be below \$10 but the cumulative amount for two or more quarters is above \$10, an intra-annual refund is then permitted.

The manner in which the quick refund works can be illustrated by the example of a husband and wife, both over age 65, who receive interest payments of \$1,500 four times a year. Assume that this is their only income and it is subject to withholding. Assume further that the couple expect to file a joint return for the year, are allowed four exemptions, and that each receives half of the income. Both are eligible for the maximum retirement income credit.

Calculation of refund allowance

(1) Allowance for exemptions (4×\$600).....	\$2, 400
(2) Plus: Allowance for retirement income credit (\$1,200 for each of them).....	2, 400
(3) Less: Income subject to tax, other than dividends and interest subject to withholding.....	
(4) Total.....	4, 800
(5) Refund allowance for year, 22 percent of line (4).....	1, 056

	1st quarter	2d quarter	3d quarter
(6) Amount withheld (20 percent of \$1,500).....	\$300	\$300	\$300
(7) Refund allowance for year.....	1, 056	1, 056	1, 056
(8) Refund for prior quarters.....		300	600
(9) Refund allowance (7) - (8).....	1, 056	756	456
(10) Refund (smaller of (6) or (9)).....	300	300	300

At the end of the year the couple will compute their tax (\$120) in the usual manner. From this they will deduct the amount withheld. Initially \$1,200 was withheld but through refunds in the first three quarters this was reduced to \$300. After offsetting the tax of \$120, there still would remain a refund of \$180 at the end of the year. This could be claimed by filing the final return in January following the end of the year.

In addition to the use of exemption certificates and intra-annual refunds as outlined above, taxpayers required to file declarations of estimated tax may take credit on such declarations for amounts withheld with respect to interest and dividends in the same manner as they presently do in the case of wage and salary withholding (sec. 6015). In addition, an ordinary annual refund claim may be made with respect to excessive withholding on interest and dividends as is presently true of wage withholding (see amendment to sec. 6401).

One further type of crediting is also provided by the bill. This relates to withholding on interest, dividends, and patronage dividends received by dependent children of the taxpayer who have not filed exemption certificates. In such cases, if the child has not separately filed a claim for refund, and the child's gross income is less than \$600

and is not subject to any wage withholding, then the parent of the child may, on the parent's return, claim a credit for the amount of the withheld tax with respect to the child's interest, dividend, or patronage dividend.

4. *Exemption certificates, intraannual refunds and credits for governments and exempt organizations.*—In the case of savings account and Government savings bonds the bill provides that exemption certificates can be filed by exempt organizations (other than exempt cooperatives). In these cases the exemption certificates once filed remain in effect as long as the organization is exempt. The same effect is achieved in the case of States, local governments, foreign governments and international organizations by the exceptions making withholding inapplicable in the case of the same types of interest.

The bill also provides that the governmental unit or tax-exempt organization may offset the withholding on dividends and interest income it receives against the amount it is required to withhold with respect to its employees for social security and Federal income tax purposes (sec. 3505).

In addition, refunds may be claimed in the case of these State or local governments or tax-exempt organizations for amounts not credited in the manner described above against social security or wage withholding taxes. These refunds may be made to the governmental unit or exempt organization on a quarterly basis during the year of liability. Quarterly refunds may also be filed by the U.S. Government and by foreign governments or international organizations and foreign central banks of issue (to the extent the income on which the withholding occurs in the latter case is not derived from any commercial banking functions (sec. 3485)).

5. *Credits or refunds for corporations.*—Because of the 85-percent intercorporate dividends received deduction, any net tax on dividends received by corporations is likely to be less than 8 percent. In addition to the low rate of tax applicable, there has been little difficulty in collecting tax from corporations. In view of these considerations, the bill permits the crediting or quarterly refunding of the entire amount withheld in the case of amounts received by corporations.

First, any amount withheld on interest and dividend payments received by corporations (including cooperatives) can be claimed as credits against the tax they are required to withhold with respect to their own dividend and interest payments (sec. 3487). For this purpose, withholding on interest and dividends received by one corporation may be claimed as credit against interest or dividend payments made by another corporation which is a member of the same affiliated group.

Any amount withheld with respect to interest and dividends received by a corporation in excess of the credits it claims with respect to its own withholding on interest and dividends may be refunded to the corporation on a quarterly basis (during the year of liability) (sec. 3486). In addition, for purposes of an estimated tax required of a corporation, any amount withheld (which is not credited or refunded as provided above) may be treated as a payment of the corporation's estimated tax (sec. 6655(f)).

6. *Nonresident aliens and foreign corporations in the case of nominees.*—Although the present withholding statutory withholding rate on payments to nonresident aliens and foreign corporations is 30 percent, this rate has been lowered by regulations in many cases to conform with the tax rates under treaty provisions. As a result, the withholding rate applicable in these cases may be either above or below the 20 percent applicable under this bill to domestic dividend and interest payments. Where the dividend or interest payor makes the payment directly to the nonresident alien or foreign corporation, as under present law, he can apply the proper withholding rate. However, under present law where the interest or dividend payor makes the payment to a nominee, the latter withholds the appropriate amount.

Under the bill no special problem exists where the applicable withholding rate with respect to the nonresident alien or foreign corporation exceeds the 20-percent domestic withholding rate. In such cases where the nominee is the withholding agent he needs only to withhold the additional amount. A problem would exist, however, where the applicable withholding rate is less than the domestic 20-percent rate. This problem is met in the bill by providing that the amount required to be withheld, regardless of any treaty less than 20 percent. This, of course, does not change the actual rate of tax in such cases and any excess amounts withheld can be recovered by the aliens through refund claims. It is not intended that any inference should be drawn from the amendment as to whether there is presently any treaty requiring withholding at less than a 20-percent rate.

7. *Obligations sold between interest payment dates.*—Where an interest-bearing bond or other obligation is sold or exchanged between the interest payment dates, the bill provides that the amount withheld is to be treated as divided between the seller and the purchaser (or transferor and transferee) in proportion to the time (with respect to which the interest relates) which each holds title to the obligation. It is anticipated that the buyer and seller in such cases will take this treatment into account in the price at which the bond is sold. Thus, in the case of a \$100 interest payment where the seller of the obligation has held the bond for half of the interest payment period in question, he presumably will demand \$10 less than he otherwise would from the purchaser of the bond, since he knows that at the time of reporting his income for tax purposes he may claim a credit equal to this amount. Thus, he will demand of the purchaser one-half of the "net" interest (other factors being equal), or one-half of \$80; namely, \$40. This, plus the \$10 for which he can claim a credit, will provide him with the interest for the half of the period for which he held the obligation.

8. *Effective date.*—In general, this provision is to apply in the case of interest and dividends paid on or after January 1, 1963. (However, in the case of transferable obligations, the bill is to apply only to interest paid with respect to interest-payment periods commencing on or after January 1, 1963). In the case of patronage dividends paid on or after January 1, 1963, the bill is to apply with respect to patronage occurring on or after the first day of the first taxable year of the cooperative beginning on or after January 1, 1963.

XXI. INFORMATION WITH RESPECT TO FOREIGN ORGANIZATIONS

(Sec. 20 of the bill and secs. 6038, 6046, and 6678 of the code)

A. *Reasons for provision*

Representatives of the administration in appearances before your committee have asked for the right to obtain more information with respect to operations of Americans abroad. First, with respect to the annual information return, now required of domestic corporations controlling foreign corporations, it was requested that this return also be required of individual citizens or residents of the United States controlling foreign corporations. Second, in addition to the various specified types of information now required to be submitted, it was also requested that the Treasury Department be permitted to require the furnishing of other information to that which is similar or related in nature to that specified in the existing provision. Third, existing law requires the supplying of this information with respect to a foreign subsidiary, or a subsidiary of such a subsidiary. It was desired that this information also be required of any other controlled foreign corporation. Fourth, it was requested that the definition of "control" be broadened to include most of the constructive ownership rules generally applied elsewhere in the code.

The administration also requested that the information return now required of officers, directors, and significant shareholders of foreign corporations upon the creation, organization, or reorganization of such corporations also be required of persons when they *become* officers, directors, or important shareholders.

In addition, the administration requested that a civil penalty be provided for those failing to file the returns as to organization, reorganization, etc., of foreign corporations. The penalty in this case is to be \$1,000 unless it can be shown that the failure is due to reasonable cause.

Your committee agreed that the submission of this additional information was desirable to give greater assurance that the proper U.S. taxes are paid in the case of these foreign operations.

B. *General explanation of provision*

1. *Annual information return.*—In 1960 (Public Law 86-780), Congress enacted legislation providing that domestic corporations must furnish with respect to foreign corporations which they control and also with respect to foreign subsidiaries of any such foreign corporations information specifying—

(1) The name, place, and nature of business of the foreign corporation and country of incorporation;

(2) The accumulated profits of the foreign corporation or subsidiary, including items of income, deduction, and other items taken into account in computing these accumulated profits;

(3) A balance sheet of the foreign corporation or foreign subsidiary;

(4) Transactions between the foreign corporation or foreign subsidiary and (a) other foreign corporations or foreign subsidiaries controlled by the domestic corporation, (b) the domestic

corporation or (c) any shareholder owning at least 10 percent of the stock of the domestic corporation; and

(5) A description of the various classes of stock outstanding and name and address and number of shares held by each citizen or resident of the United States and domestic corporation holding 5 percent or more of the stock of the foreign corporation or foreign subsidiary.

Corporations failing to supply the information required received reductions in their foreign tax credit otherwise available with respect to the income derived from the foreign corporations or their subsidiaries, from 10 percent up, depending upon the period of time the failure continued.

Your committee's bill amends this information provision in several respects. First, it requires U.S. citizens or residents, domestic partnerships and domestic estates or trusts as well as domestic corporations controlling the foreign corporations to supply the information specified. Second, "control" is redefined by adding most of the constructive ownership rules of the existing section 318(a). Third, the bill also extends somewhat the type of foreign corporation with respect to which information must be supplied. Existing law applied to foreign corporations controlled by Americans and subsidiaries which they control. In other words, it applies to two levels of ownership of foreign corporations. The bill extends the requirement to apply to any number of levels of ownership so long as there is control of the corporations involved. Fourth, in addition to the listed types of information, the Treasury Department may also require the furnishing of any other information which is similar or related in nature to that specified.

2. Information with respect to organization, reorganization, etc.— Present law also requires U.S. citizens or residents who are officers or directors of a foreign corporation within 60 days of its creation, organization or reorganization, and also U.S. persons who within the same 60-day period own 5 percent or more of the value of the stock of the corporation, to supply information with respect to this corporation. The return is required to contain such information as the Secretary of the Treasury or his delegate prescribes by forms or regulation as necessary to carry out the provisions of the income tax laws.

Under existing law it is possible to avoid this information requirement where the U.S. citizen or resident first becomes an officer, director, or owner of 5 percent or more of the value of the stock of the corporation after the 60-day period. To prevent this avoidance of the information requirement the bill extends the requirement for supplying the information so that it applies to those U.S. citizens or residents who are officers, directors, or shareholders with more than a 5-percent interest on January 1, 1963, or who acquire such positions after that date. This information also is to be supplied with respect to shareholders whose holdings after that date are increased to 5 percent (or where they acquire an additional 5 percent of the stock of the corporation).

Your committee has also added a new section to the code providing a civil penalty in the case of any person required to file the return referred to here who fails to do so at the time required, or who files

a return which does not show the information required. The penalty in this case is to be \$1,000 unless it is shown that the failure is due to reasonable cause.

3. *Effective dates.*—The amendments with respect to the annual information return apply with respect to annual accounting periods of the foreign corporations beginning after December 31, 1962. The amendments relating to the filing of returns as to organization, reorganization, etc., of foreign corporations takes effect on January 1, 1963.

XXII. TREATIES

(Sec. 21 of bill and sec. 7852(d) of code)

Section 7852(d) of the code provides that no provision of the Internal Revenue Title is to apply where its application would be contrary to any treaty obligation of the United States in effect on the date of the enactment of the Internal Revenue Code. Some believe that certain of the provisions of this bill may contravene provisions of existing income tax treaties. Your committee in the interest of forestalling any possible litigation on this point desired to make it clear that section 7852(d) is not to apply to any provision contained in this bill and if any provision of this bill should contravene any existing tax treaty, then the new statutory law is intended to have precedence over the prior treaty obligation.

XXIII. NEW ELECTION TO FILE SEPARATE RETURNS WHERE CONSOLIDATED RETURN HAD BEEN FILED

The Internal Revenue Code leaves to regulations issued by the Treasury Department requirements as to the filing of consolidated returns by an affiliated group and the requirements for changing from a consolidated return to separate returns. Generally it has been held that a consolidated return once filed must be continued in subsequent years unless there is a significant change in the tax laws. This is a matter which has been considered by your committee in connection with this bill and it believes that a new election to file separate returns where a consolidated return has previously been filed should be available for the first taxable year ending after the date of enactment of this bill.

TECHNICAL EXPLANATION OF THE BILL

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TECHNICAL EXPLANATION OF THE BILL

SECTION 1. SHORT TITLE, ETC.

(a) *Short title.*—Section 1(a) of the bill provides that the bill may be cited as the “Revenue Act of 1962.”

(b) *Table of contents.*—Section 1(b) of the bill consists of a table of contents for the bill.

(c) *Amendment of 1954 Code.*—Section 1(c) of the bill provides that whenever in the bill an amendment or repeal is expressed in terms of an amendment to (or repeal of) a section or other provision, the reference is to be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

SECTION 2. CREDIT FOR INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY

(a) *Allowance of credit.*—Section 2(a) of the bill redesignates section 38 of the code as section 40 and inserts a new section 38 in part IV of subchapter A of chapter 1 (relating to credits against tax).

Subsection (a) of the new section 38 provides that there is to be allowed, as a credit against the tax imposed by chapter 1 of the code, the amount determined under the new subpart B, added by section 2(b) of the bill. Subsection (b) of the new section 38 requires the Secretary of the Treasury or his delegate to prescribe such regulations as may be necessary to carry out the purposes of the new section 38 and the new subpart B.

(b) *Rules for computing credit.*—Section 2(b) of the bill adds a new subpart B to part IV of subchapter A of chapter 1 of the code. The new subpart consists of three sections (sec. 46–48) which are explained below.

SECTION 46. AMOUNT OF CREDIT

(a) *Determination of amount.*—Paragraph (1) of section 46(a) provides in general that the credit allowed for the taxable year is to be an amount equal to 8 percent of the qualified investment as defined in subsection (c) of section 46. Under paragraph (2) of section 46(a) the amount of the credit may not exceed so much of the liability for tax for the taxable year as does not exceed \$100,000 plus 50 percent of so much of such liability as exceeds \$100,000. However, the \$100,000 amount provided by section 46(a)(2) is reduced in the case of certain married individuals filing separate returns (see sec. 46(a)(4)), corporations which are members of affiliated groups (see sec. 46(a)(5)), trusts and estates (see sec. 48(f)(3)), and certain other special types of taxpayers referred to in section 46(d).

Under paragraph (3) of section 46(a), the liability for tax for the taxable year is defined as the tax imposed by chapter 1 (including the 2-percent tax on consolidated taxable income) reduced by the sum of the credits against the income tax allowed by sections 33, 34, 35, and

37. For purposes of determining the liability for tax, the taxes imposed by sections 531 and 541 (relating, respectively, to the accumulated earnings tax and the personal holding company tax) are not considered taxes imposed by chapter 1. Thus, the liability for tax as defined in section 46(a)(3) and the credit allowable for the taxable year under section 38 are determined before computing any tax imposed by section 531 or 541.

Paragraph (4) of section 46(a) provides generally that, in the case of separate returns filed by a husband and wife, the credit allowed to each may not exceed so much of the liability for tax for the taxable year as does not exceed \$50,000 plus 50 percent of so much of such liability as exceeds \$50,000. However, this reduction in the limitation applies only if the taxpayer's spouse is entitled to an investment credit for the taxable year of such spouse which ends with, or within, the taxpayer's taxable year. Such spouse may be entitled to an investment credit either because of qualified investment for (whether directly made or whether allocated to such spouse by, for example, a subch. S corporation or a partnership), or because of an unused credit carryover to, such taxable year.

Paragraph (5) of section 46(a) provides generally that the \$100,000 amount specified in subparagraphs (A) and (B) of section 46(a)(2) is to be reduced for each corporation which is a member of an affiliated group by apportioning \$100,000 among the members of such group in the manner prescribed by regulations of the Secretary or his delegate. An affiliated group within the meaning of section 46(a)(5) is one described in section 1504(a), except that any corporation may be treated as a member of an affiliated group. Thus, an affiliated group for purposes of section 46(a)(5) may include any of the corporations excluded by section 1504(b) from being a member of an affiliated group for purposes of filing a consolidated return. For example, an affiliated group within the meaning of section 46(a)(5) could include a corporation exempt from taxation under section 501 or a foreign corporation.

The application of the limitation provisions of section 46(a) may be illustrated by the following example:

The qualified investment of an unmarried taxpayer is \$2,050,000. His liability for tax for the taxable year is \$185,000. The credit computed without regard to the limitation in section 46(a)(2) is \$164,000 (8 percent of \$2,050,000). The allowable credit for the taxable year is \$142,500 (\$100,000 plus 50 percent of \$85,000).

(b) *Five-year carryover of unused credits.*—Subsection (b) of section 46 provides for a 5-year carryover of any unused credit. Under this provision, if the credit earned during the taxable year exceeds the limitation under section 46(a)(2) for that year (hereinafter referred to as “unused credit year”), the excess (the credit earned but not used to reduce tax for that year) is carried forward and added to the amount which would be allowable as a credit for each of the 5 succeeding taxable years to the extent the unused credit is not used to reduce tax for taxable years intervening between the unused credit year and the succeeding taxable year. The amount of the unused credit which may be so taken into account in any of the 5 succeeding taxable years is not to exceed the amount by which the limitation determined under section 46(a)(2) for such succeeding taxable year exceeds the sum of (1) the credit allowable for such succeeding taxable

year by reason of investment made in such year, and (2) other allowable unused credits which are attributable to years prior to the taxable year in which the unused credit originated. In determining the amount of the unused credit from a prior taxable year which may be taken into account in a succeeding taxable year, the credit allowable for the succeeding taxable year (determined without regard to carryovers of unused credits to that year) will first be applied. Unused credits originating from taxable years prior to the unused credit year will be applied next. If the credit earned and allowable for a succeeding taxable year, or the unused credits originating from taxable years prior to the unused credit year, exceed the limitation for such succeeding taxable year, the unused credit from the unused credit year will be carried forward to the next succeeding taxable year.

The application of the carryover of the unused credit provided for in subsection (b) of section 46 may be illustrated by the following example:

A taxpayer's credit based on his investment for the taxable year 1962 amounts to \$120,000, and the limitation under section 46(a)(2) is \$110,000. The taxpayer's unused credit for 1962 amounts to \$10,000 (\$120,000 minus \$110,000), which he may carry forward to 1963 and the 4 succeeding taxable years. The credit based on his investment for 1963 is \$135,000, and the limitation under section 46(a)(2) is \$120,000. Since the taxpayer is limited to a credit of \$120,000 for 1963, his total unused credits to be carried forward to 1964 amount to \$25,000, \$10,000 from 1962 and \$15,000 from 1963. The credit based on his investment for 1964 is \$135,000, and the limitation under section 46(a)(2) is \$140,000. The taxpayer first applies the \$135,000 for 1964 against the \$140,000 limitation. He next applies any unused credit carried forward from 1962 against the remaining \$5,000 allowable. Since the \$10,000 credit carried forward from 1962 is in excess of the \$5,000 remaining amount allowable for 1964, he has unused credits to carry over to 1965 of \$20,000, \$5,000 from 1962 and \$15,000 from 1963.

(c) *Qualified investment.*—Paragraph (1) of section 46(c) defines “qualified investment” to mean, with respect to any taxable year, the aggregate of the applicable percentage of the basis of each new section 38 property placed in service by the taxpayer during such taxable year, plus the aggregate of the applicable percentage of the cost of each used section 38 property placed in service by the taxpayer during such taxable year. Under paragraph (2) of section 46(c), the applicable percentage to be applied to the basis (or cost) is: (1) 33½ percent if the estimated useful life is 4 years or more but less than 6 years, (2) 66½ percent if the estimated useful life is 6 years or more but less than 8 years, and (3) 100 percent if the estimated useful life is 8 years or more.

The basis of “new section 38 property” is to be determined under the general rules for determining the basis of property. Thus, the basis of property purchased or constructed would generally be its cost. If property is acquired in a nontaxable exchange to which section 1031 applies by trading in old property and paying a cash difference, the basis of the newly acquired property would be equal to the adjusted basis of the old property, plus the cash paid.

The cost of each “used section 38 property” is to be determined in accordance with section 48(c)(3)(B). However, the aggregate cost

of used section 38 property which may be taken into account in any taxable year in computing qualified investment cannot exceed \$50,000. (See sec. 48(c)(2).)

The credit will apply to property only for the first taxable year such property is placed in service by the taxpayer. The date on which property is placed in service is the first date depreciation would be allowable to the taxpayer if he computed his depreciation deduction on a daily basis. Thus, in determining the date an asset is placed in service, the fact that the taxpayer, in computing his depreciation allowance, uses an assumed timing of additions under one of the "averaging conventions" is to be disregarded, but only for the purposes of the investment credit.

The estimated useful life of any property is to be determined as of the time such property is placed in service by the taxpayer, and with reference to the useful life in the hands of the taxpayer. Thus, if a taxpayer acquires used section 38 property with a remaining useful life of 3 years in his hands, such property will not qualify regardless of the original estimated useful life to the previous owner. See section 48(d) for the useful life to be used by certain lessees. The estimate of the useful life is to be based on the facts and circumstances known on the date the asset is placed in service.

An estimated useful life must be assigned to each separate property. Thus, if a taxpayer is using a multiple-asset account, he must assign a useful life to each asset in such account for the purpose of computing his qualified investment. If a taxpayer is using a method of depreciation, such as the units of production method, which does not measure useful life in terms of years, he must estimate useful life in years in order to compute his qualified investment.

The provisions of paragraphs (1) and (2) of section 46(c) may be illustrated by the following examples:

Example (1).—Corporation Y acquires and places in service during 1962 the following new and used section 38 assets:

Property	Estimated useful life	Basis or cost
	<i>Years</i>	
A (new).....	5	\$60,000
B (new).....	10	90,000
C (new).....	6	150,000
D (used).....	4	30,000

Corporation Y's qualified investment for 1962 is \$220,000 determined in the following manner:

Property	Basis or cost times applicable percentage	Qualified investment
A.....	\$60,000×33½ percent.....	\$20,000
B.....	\$90,000×100 percent.....	90,000
C.....	\$150,000×66⅔ percent.....	100,000
D.....	\$30,000×33½ percent.....	10,000
Total.....		220,000

Example (2).—Mr. X, unmarried, owns and operates a business as a sole proprietorship and reports income on a calendar year basis.

He is also a member of the XYZ partnership, which is also on a calendar year basis. During 1962 Mr. X acquires and places in service in his sole proprietorship a new section 38 property having an estimated useful life of 9 years and a basis of \$25,000. Also during 1962 the XYZ partnership acquires and places in service a new section 38 property having an estimated useful life of 4 years to the partnership and a basis of \$18,000.

X's share of the basis of the new section 38 property acquired by partnership XYZ is \$6,000. X's qualified investment for 1962 is \$27,000, composed of \$25,000 from his sole proprietorship (basis of \$25,000 times applicable percentage, 100 percent), and \$2,000 attributable to the property of the XYZ partnership (basis of \$6,000 times applicable percentage, 33⅓ percent).

Public utility property

Paragraph (3)(A) of section 46(c) provides that in the case of section 38 property which is public utility property, the amount of the qualified investment is to be 50 percent of the amount ascertained under section 46(c)(1) with respect to such property.

Paragraph (3)(B) of section 46(c) defines "public utility property" as property used predominantly in the trade or business of the furnishing or sale of (i) electrical energy, water, or sewage disposal services, (ii) gas through a local distribution system, (iii) telephone service, or (iv) telegraph service by means of domestic telegraph operations (as defined in sec. 222(a)(5) of the Communications Act of 1934, as amended; 47 U.S.C., sec. 222(a)(5)), if the rates for such furnishing or sale have been established or approved by a State (as defined in sec. 7701(a)(10) of the code) or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof. The term "established or approved" by a State, etc., includes the filing of a schedule of rates with any of the named bodies having the power to approve such rates, even though such body has taken no action on the filed schedule.

If a taxpayer is engaged in one or more regulated activities enumerated in section 46(c)(3)(B) (hereinafter referred to as a utility activity) and is also engaged in a separate trade or business that is not considered a utility activity, property used in the latter trade or business is not subject to the reduction contained in paragraph (3)(A) of section 46(c). If property is used by a taxpayer both in a utility activity and a nonutility activity, the characterization of such property is to be based on the predominant use of such property during the taxable year the property is placed in service. Once property is characterized as public utility property, the fact that in any subsequent year such property is used predominantly in the nonutility business is to be disregarded.

"Public utility property" includes property leased to a taxpayer which uses such property predominantly in a utility activity. Thus, property leased to a taxpayer which uses the property predominantly in a utility activity during a taxable year is to be treated as public utility property for purposes of computing the lessor's credit. "Public utility property" also includes property which is leased to others by a taxpayer where the leasing of such property is part of its utility activity.

Section 38 property which is not public utility property is not subject to the 50-percent reduction contained in section 46(c)(3)(A). Thus, for example, in the case of property which is used predominantly in international telegraph operations, which is not used predominantly outside the United States, and which otherwise qualifies as section 38 property, the qualified investment is to be determined without reduction by reason of section 46(c)(3)(A).

The provisions of section 46(c)(3) may be illustrated by the following example:

Corporation X is engaged in a trade or business of furnishing telephone services, the rates of which have been established by a public utility commission. Corporation X is also engaged in a separate nonutility trade or business. During 1962 corporation X acquires and places in service two new section 38 properties, each with a basis of \$30,000 and an estimated useful life of 7 years. One of these properties is used exclusively in the utility activity. The other property is also used at times in the utility activity, but is used in the separate nonutility trade or business more than 50 percent of the time during the taxable year 1962. Corporation X's qualified investment is \$30,000, which includes \$20,000 attributable to nonutility property (\$30,000 basis times applicable percentage, 66⅔ percent) plus \$10,000 attributable to public utility property (50 percent times (\$30,000 basis times applicable percentage, 66⅔ percent)).

(d) *Limitations with respect to certain persons.*—Subsection (d) of section 46 limits the applicability of the credit with respect to certain persons. Paragraph (1) of section 46(d) provides that both the qualified investment and the \$100,000 amount specified under subparagraphs (A) and (B) of section 46(a)(2) are to be equal to a ratable share of such items in the case of the following organizations:

(1) mutual savings banks, cooperative banks, and domestic building and loan associations, to which section 593 applies;

(2) regulated investment companies and real estate investment trusts subject to tax under subchapter M; and

(3) cooperative organizations described in section 1381(a).

Under paragraph (2)(A) of section 46(d), in the case of a mutual savings bank, etc., its ratable share of the qualified investment and the \$100,000 amount specified in subparagraphs (A) and (B) of section 46(a)(2) is equal to 50 percent of such items.

Under paragraph (2)(B) of section 46(d), in the case of a regulated investment company or a real estate investment trust, the qualified investment and the \$100,000 amount specified in subparagraphs (A) and (B) of section 46(a)(2) are to be taken into account in the same proportion as its taxable income (as defined in sec. 852(b)(2) or section 857(b)(2), respectively) bears to such taxable income computed without regard to the deduction for dividends paid (as defined in sec. 852(b)(2)(D) or 857(b)(2)(C), respectively).

Under paragraph (2)(C) of section 46(d), a cooperative organization described in section 1381(a) is to take into account its qualified investment and the \$100,000 amount specified in subparagraphs (A) and (B) of section 46(a)(2) in the same proportion as its taxable income bears to its taxable income increased by amounts to which section 1382 (b) or (c) applies and similar amounts the tax treatment of which is determined without regard to subchapter T (sec. 1381 and following). Thus, in the case of a taxable year of a cooperative

organization beginning before January 1, 1963, the denominator of the proportion for such organization is determined by adding to its taxable income any patronage dividends which are excluded or deducted and any nonpatronage distributions which are deducted under section 522(b)(1). In the case of any taxable year of the organization beginning after December 31, 1962, the denominator is determined by adding to taxable income (in addition to amounts to which sec. 1382 (b) or (c) applies) any amounts of the type described in the preceding sentence which are excluded or deducted without regard to section 1382 (b) or (c) because they are attributable to patronage occurring before 1963.

If any of these special taxpayers to which section 46(d) applies are members of an affiliated group as defined in section 46(a)(5), the \$100,000 amount specified in subparagraphs (A) and (B) of section 46(a)(2) is to be reduced in accordance with section 46(a)(5) before determining the ratable share of such item under section 46(d).

The provisions of section 46(d) may be illustrated by the following example:

The total qualified investment of a regulated investment company is \$150,000, and its investment company taxable income is \$50,000 after taking into account the deduction for dividends paid provided by section 852(b)(2)(D), and \$1 million without regard to such deduction. Such organization's qualified investment would be \$7,500

$\left(\$150,000 \times \frac{\$50,000}{\$1,000,000} \right)$. Similarly, the \$100,000 amount specified in subparagraphs (A) and (B) of section 46(a)(2) would be reduced to \$5,000 $\left(\$100,000 \times \frac{\$50,000}{\$1,000,000} \right)$, and the 50-percent limitation of section 46(a)(2)(B) would apply to the tax liability in excess of \$5,000.

SECTION 47. CERTAIN DISPOSITIONS, ETC., OF SECTION 38 PROPERTY

(a) *In general.*—Section 47 provides, in general, for an adjustment of prior credits (and credit carryovers) and an increase in the tax imposed by chapter 1 if property (1) is disposed of or otherwise ceases to be section 38 property with respect to the taxpayer before the close of the useful life which was taken into account with respect to such property in computing the credit, or (2) becomes public utility property. Subsection (a) of section 47 provides that adjustments due to the application of section 47 and increases in tax resulting from such adjustments are to be determined under regulations prescribed by the Secretary or his delegate.

Early disposition, etc.

Under paragraph (1) of section 47(a), the tax for a taxable year in which property is disposed of or otherwise ceases to be section 38 property before the close of the useful life which was taken into account in computing the credit is to be increased by the amount by which the credits allowed under section 38 for all prior taxable years have been decreased by reason of adjustments of the credits for such taxable

years. Such adjustment is to be made by recomputing qualified investment for the year in which the basis (or cost) of the property that ceases to be section 38 property was included in qualified investment and by recomputing the credit (and credit carryovers) accordingly. Qualified investment is to be recomputed by substituting, in lieu of the estimated useful life of the property that was originally taken into account in applying the applicable percentage, the period beginning with the time such property was placed in service by the taxpayer and ending with the time such property ceased to be section 38 property. This period is hereinafter referred to as the actual period of use. In determining the amount of the aggregate decrease in the credits allowed for all prior taxable years, due regard is to be accorded any previous recomputations of qualified investment, credits, and credit carryovers resulting from a prior application of section 47. Of course, if the actual period of use would have no effect on the appropriate applicable percentage to be applied, no adjustment is necessary. Thus, for example, if the estimated useful life is 10 years, and a disposition occurs resulting in an actual period of use of 8 years, no adjustment results, since the applicable percentage remains 100 percent in either case.

Except as provided in section 47(b), whenever section 38 property is disposed of, such property ceases to be section 38 property with respect to the taxpayer. In general, property will be considered disposed of whenever it is sold, exchanged, transferred, distributed, involuntarily converted, or disposed of by gift. Thus, a cessation will occur when property is contributed to a partnership or to a corporation. (However, see sec. 47(b) for an exception where the contribution of property constitutes a mere change in the form of operating the trade or business.) Generally, the lease of property is not considered to be a disposition for purposes of applying section 47. However, if a taxpayer leases out property which he would ordinarily dispose of by sale or exchange and it appears that a purpose of the lease is to avoid the application of section 47, then such lease will be considered a disposition.

Additional examples of property ceasing to be section 38 property include (1) property (or a portion thereof) which is no longer subject to depreciation with respect to the taxpayer because, for example, it is shifted from a business to a personal use, (2) property which is used in any taxable year predominantly outside the United States by a governmental unit, etc. Similarly, property of a partnership (or subch. S corporation or estate or trust) ceases to be section 38 property with respect to the taxpayer (partner, shareholder, or beneficiary) when such taxpayer sells his interest in the partnership (or shares of stock or beneficial interest). Furthermore, when section 38 property is leased, and the lessor elects to treat the lessee as the purchaser of the property under section 48(d), a termination of the lease and disposition of the property by the lessee will result in the application of section 47 with respect to the lessee.

The provisions of section 47(a)(1) may be illustrated by the following example:

Corporation X acquires and places in service a new section 38 asset on January 1, 1963. Such asset has a basis of \$30,000 and an estimated useful life of 8 years. Assuming this is the only section 38 asset corporation X places in service during its taxable year ending

December 31, 1963, X's qualified investment is \$30,000 (\$30,000 basis times applicable percentage, 100 percent). Such investment entitles X to a credit of \$2,400 (8 percent times \$30,000). Corporation X's liability for tax for 1963 is \$100,000, and X reduces its tax liability by the full \$2,400. On January 1, 1968, corporation X sells such asset. There will be added to the taxes imposed by chapter 1 for X's taxable year ended December 31, 1968, \$1,600 which is the aggregate decrease in credits allowed resulting solely from substituting a 5-year life for such asset in computing qualified investment in 1963. The sum of \$1,600 is arrived at by first applying an applicable percentage of 33⅓ percent to the basis, resulting in an adjusted qualified investment of \$10,000 (\$30,000 basis times 33⅓ percent, the applicable percentage based on the actual period of use of 5 years). Since the recomputed qualified investment results in an adjusted credit of \$800 (8 percent times \$10,000) the aggregate decrease in credits is \$1,600 (\$2,400 credit allowed minus \$800 adjusted credit).

Property becomes public utility property

Section 47(a)(2) provides that the credit is to be adjusted if during any taxable year any property previously taken into account in determining qualified investment as nonutility property becomes public utility property. Property becomes public utility property if in any one taxable year the property is used predominantly in a trade or business described in section 46(c)(3)(B) by the taxpayer or by a person leasing such property from the taxpayer. Once such property becomes public utility property in the hands of the taxpayer, the fact that in any subsequent year such property is used by such taxpayer predominantly in a nonutility activity is to be disregarded. (See sec. 46(c)(3)(B) for the definition of public utility property.)

In such a case, the tax liability for the taxable year in which the property becomes public utility property is to be increased by the amount that the credits allowed under section 38 for all prior taxable years is decreased by the adjustment. The adjustment is to be made by treating the property as public utility property beginning with the year the property was placed in service, but with due regard to the use of the property as nonutility property before such change in use. For purposes of the adjustment, it is assumed that the property will continue to be used as section 38 public utility property for the estimated useful life of the property which was taken into account in computing the credit in the year the property was placed in service.

The following table indicates the applicable percentage to be applied to the basis (or cost) of property which becomes public utility property for purposes of adjusting the credit. This table takes into account the 50-percent reduction required by section 46(c)(3)(A) in the case of public utility property, and gives due regard to the period during which the property is used as nonpublic utility property before the change in use.

	Original estimated useful life		
	4 to 6 years	6 to 8 years	8 years or more
If, before becoming utility property, property is held as non-utility property:			
Less than 4 years, the applicable percentage is-----	16 $\frac{2}{3}$ %	33 $\frac{1}{3}$ %	50
4 or 5 years, the applicable percentage is-----	33 $\frac{1}{3}$ %	50	66 $\frac{2}{3}$ %
6 or 7 years, the applicable percentage is-----	33 $\frac{1}{3}$ %	66 $\frac{2}{3}$ %	83 $\frac{1}{3}$ %
8 years or more, the applicable percentage is-----	33 $\frac{1}{3}$ %	66 $\frac{2}{3}$ %	100

Thus, if property with an original estimated useful life of 8 years is used predominantly as public utility property after use as non-utility property for 4 years, the applicable percentage to be used in adjusting the credit under section 47(a)(2) is 66 $\frac{2}{3}$ percent (in lieu of the applicable percentage of 100 originally used for nonutility property having a useful life of 8 years or more). If property becomes public utility property and section 47(a)(2) applies, and if such property is subsequently disposed of or used in a manner causing section 47(a)(1) to apply, proper adjustment for the fact that section 47(a)(2) has previously applied is to be made in applying section 47(a)(1).

Carryovers adjusted

Section 47(a)(3) provides that carryovers of unused credits under section 46(b) are to be adjusted by reason of a disposition or other cessation described in section 47(a)(1), or by reason of a change in use described in section 47(a)(2). Thus, even if the recomputation of qualified investment required by section 47(a)(1) does not result in a decrease in the credits allowed, credit carryovers are to be adjusted.

The provisions of section 47(a)(3) may be illustrated by the following example:

In 1962, corporation X acquired and placed in service a number of section 38 assets. One of these was asset A which has a basis of \$300,000 and an estimated useful life of 8 years. X's qualified investment and tax liability for such year were \$2 million and \$200,000, respectively. In 1962, X's tentative credit was \$160,000 (8 percent times \$2 million), but because of the limitation contained in section 46(a)(2) the credit allowed for such year was \$150,000 (\$100,000 plus 50 percent of \$100,000). Therefore, a \$10,000 credit carryover was available for 1963 and succeeding years. On January 1, 1969, X trades in asset A in exchange for a new asset. Under these facts, corporation X must adjust its credit for 1962 by recomputing the qualified investment attributable to asset A. The original qualified investment with respect to asset A was \$300,000 (\$300,000 basis times applicable percentage, 100 percent); the recomputed qualified investment is \$200,000 (\$300,000 basis times applicable percentage, 66 $\frac{2}{3}$ percent based on the actual period of use of asset A). Therefore, the total recomputed qualified investment is \$1,900,000 (\$2 million minus \$100,000). In this case, the adjustment of the credit for 1962 will not affect the credit allowed in 1962 but will reduce the credit allowable as a carryover to 1963 and succeeding years. This is because in recomputing the credit, X's credit is reduced to \$152,000 (8 percent times \$1,900,000). Since X's adjusted credit is still in excess of the limitation of \$150,000 for 1962, there is no decrease in credits allowed in 1962, and hence no increase in X's tax liability for 1969 attributable

to credits allowed in 1962. Thus, only the \$10,000 unused credit carryover from 1962 is affected by the recomputation. Such carryover as adjusted is \$2,000 (\$152,000 adjusted credit for 1962 minus \$150,000 credit used in 1962). To the extent more than \$2,000 of the original carryover from 1962 has been used by the taxpayer as a credit against tax for 1963 or any succeeding year, such credits shall be adjusted and the decrease attributable thereto will be added to X's 1969 tax. However, if no more than \$2,000 of the original \$10,000 unused credit carryover has been used as a credit against tax, the result of the adjustment would be only to reduce the credit carryover.

(b) Section not to apply in certain cases.—Subsection (b) of section 47 provides exceptions to the adjustments required by section 47(a).

The first exception provides that section 47(a) will have no application to the transfer of property which arises by reason of an individual taxpayer's death. Thus, on the death of an individual taxpayer, the transfer of the decedent's property interests to his personal representative or heirs will be disregarded. Nor will section 47(a) apply to the transfer of a deceased taxpayer's interest held in joint tenancy (either as a joint tenant, or a tenant by the entirety) to the surviving owners of the property. The effect of this provision is that all properties held by a decedent at the time of his death for which the credit has been granted will be deemed held by the decedent for the useful life estimated by the decedent in computing his credits.

Another exception provided by subsection (b) of section 47 is that section 47(a) will not apply to the transfer of property to the acquiring corporation in a transaction to which section 381(a) applies. (See sec. 381(c)(23) for the treatment to be accorded the acquiring corporation with respect to the credits of the acquired corporation, including the sec. 47 adjustments with respect to dispositions by the acquiring corporation of property transferred by the acquired corporation.)

In addition, subsection (b) of section 47 provides, in effect, a suspension of the application of section 47(a) where there has been a mere change in the form of conducting a trade or business so long as (1) the property is retained in such trade or business as section 38 property, and (2) the taxpayer retains a substantial interest in such trade or business. On the occurrence of any event which results in a failure to meet either of the conditions described above, the property will be deemed to cease to be section 38 property when such event occurs. Thus, in determining whether the property ceases to be section 38 property before the close of its useful life, the period the property was held as section 38 property before the mere change in form of conducting the trade or business will be tacked on to the period beginning with the change in form and ending with the occurrence of the event which results in a failure to meet either of the conditions specified in the first sentence of this paragraph.

The phrase "a mere change in the form of conducting the trade or business" (whether through incorporation, the formation of a partnership, or otherwise) applies only to cases where the properties of a trade or business are transferred. Thus, the transfer of section 38 assets to a newly formed corporation in a transaction to which section 351 applies will not fall within the scope of the exception unless the transaction involves the transfer of the trade or business in which such assets were used.

The determination of whether the taxpayer has retained a substantial interest in the trade or business is to be made immediately after the change in form of conducting the business, as well as after each time the taxpayer disposes of a portion of his interest in the new enterprise. However, in any case where a taxpayer's interest in the business of the new enterprise remains constant in relation to his former interest, the taxpayer will be considered as having retained a substantial interest in the trade or business. Thus, where a taxpayer owns a 5-percent interest in a partnership, and after the incorporation of that partnership the taxpayer retains a 5-percent interest in the corporation, the taxpayer will be considered as having retained a substantial interest in the trade or business as of the date of the change in form.

The provisions of section 47(b) may be illustrated by the following examples:

Example (1).—On July 1, 1962, the XYZ partnership acquires and places in service asset A, a new section 38 asset, with a basis of \$30,000 and an estimated useful life of 8 years. One-third of the basis of such asset is taken into account by each of the three partners of the XYZ partnership in computing their individual credits. On January 1, 1964, the XYZ partnership transfers all of its assets to the XYZ corporation, a newly formed corporation, in exchange for all of the stock of XYZ corporation. Such stock is then transferred pro rata to the partners. The XYZ corporation continues to operate the same trade or business formerly conducted as a partnership. On September 1, 1970, the XYZ corporation sells asset A. Assuming all the partners have continuously retained a substantial interest in the XYZ corporation and asset A was used in the business as a section 38 asset until September 1, 1970, no adjustment is required under section 47 since the total holding period of asset A for each partner exceeds 8 years (18 months while used by the XYZ partnership and 80 months while used by the XYZ corporation or a total of 8 years and 2 months).

Example (2).—On January 1, 1962, the X corporation acquires and places in service a new section 38 property (with an estimated useful life of 6 years) which it takes into account in computing a credit. Such property is used in X's manufacturing business. X corporation is also engaged in a separate personal service business. In 1963, the X corporation transfers the assets of the manufacturing business (including the sec. 38 property upon which the X corporation took a credit) to a newly formed corporation, the Y corporation. X corporation then transfers to its shareholders all of the stock of the Y corporation. Since the X corporation does not retain a substantial interest in the manufacturing business, section 47(a) will apply to the transfer of the assets to Y corporation.

(c) *Special rule.*—Subsection (c) of section 47 provides a special rule for treating the increase in tax resulting from the adjustment of the credit. In general, such increase in tax will be treated as a tax imposed by chapter 1. However, it will not be so treated for purposes of determining the amount of the credits under section 33 (relating to tax of foreign countries and possessions of the United States), section 34 (relating to dividends received by individuals), section 35 (relating to partially tax-exempt interest received by individuals), section 37 (relating to retirement income), and section 38 (relating to investment in certain depreciable property). Thus, the increase in tax is not to

be taken into account in determining a taxpayer's liability for tax as defined in section 46(a)(3), and hence will have no effect on the limitation contained in section 46(a)(2). However, all adjustments to credit carryovers to the current taxable year resulting from a cessation or change in use during such taxable year are to be taken into account in determining the amount of credit carryovers which may be used for such year.

SECTION 48. DEFINITIONS; SPECIAL RULES

(a) *Section 38 property.*—Section 48 contains various definitions and special rules necessary to the application of the investment credit. Section 48(a) defines the type of property investment which will qualify for the credit.

In general

The term "section 38 property" is defined by section 48(a)(1) as property which is tangible personal property, or which is other tangible property (not including a building and its structural components) but only if such other property is used as an integral part of manufacturing, production, extraction, or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or is a research or storage facility used in connection with any of the foregoing activities. The property described above, however, must be property with respect to which depreciation (or amortization in lieu of depreciation) is allowable, and such property must have a useful life of 4 years or more (determined as of the time such property is placed in service). (See the discussion of useful life in this report under sec. 46(c), relating to qualified investment.)

If an asset is in part subject to an allowance for depreciation and in part nondepreciable, only the proportionate part of the asset which is subject to depreciation will qualify as section 38 property. Thus, if an asset is used 80 percent of the time in a trade or business and is used 20 percent of the time for personal purposes, only 80 percent of such property will qualify as section 38 property subject to depreciation. Further, property does not qualify to the extent it is treated as property which is used for personal, living, and family purposes under section 274 (relating to disallowance of certain entertainment, etc., expenses).

Property may qualify as section 38 property if amortization is allowable with respect to such property in lieu of depreciation. Amortization in lieu of depreciation is allowable, for example, if a lessee makes improvements on leased property which have a longer estimated useful life than the remaining term of the lease and amortizes the cost of such improvements over the remaining term of the lease.

Tangible personal property may qualify as section 38 property irrespective of whether it is used as an integral part of manufacturing, production, or extraction or of the furnishing of transportation, communications, electrical energy, gas, water, or sewage disposal services. Local law definitions will not be controlling for purposes of determining the meaning of the term "tangible personal property." For purposes of section 48, the term "tangible personal property" includes any tangible property except land, and improvements thereto, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings

or structures). Assets accessory to the operation of a business, such as machinery, printing presses, transportation or office equipment, refrigerators, individual air-conditioning units, grocery counters, etc., generally constitute tangible personal property for purposes of section 48, even though such assets may be termed fixtures under local law. Further, assets in the nature of machinery will be considered "tangible personal property" for purposes of section 48 whether they are placed within or without a building or other structure. Thus, for example, a gasoline pump, or a hydraulic car lift, although not within any structure, will nevertheless be considered "tangible personal property." Intangible property, such as patents and copyrights, does not qualify as section 38 property.

Buildings and structural components thereof are not eligible for the credit. The term "building" is to be given its commonly accepted meaning, that is, a structure or edifice enclosing a space within its walls, and usually covered by a roof. It is the basic structure of an improvement to land the purpose of which is, for example, to provide shelter or housing or to provide working, office, display, or sales space. The term would include, for example, the basic structure used as a factory, office building, warehouse, theater, railway or bus station, gymnasium, or clubhouse. The term "structural components" of a building includes such parts of the building as central air-conditioning and heating systems, plumbing, and electric wiring and lighting fixtures, relating to the operation and maintenance of the building.

In addition to tangible personal property, other tangible property (not including a building and its structural components) used as an integral part of the manufacturing, production, or extraction process or as an integral part of a system of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services may qualify for the credit. Property is to be considered as being used as an integral part of a system of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services only if such property is used by one engaged in the trade or business of furnishing such services. Thus, if a manufacturing firm constructs an airstrip for use by airplanes operated for the convenience of its officers and employees, such airstrip would not qualify as section 38 property since the manufacturing firm is not engaged in the transportation business.

The terms "manufacturing," "production," "extraction," and the businesses of furnishing "transportation," "communications," "electrical energy," "gas," "water," or "sewage disposal" services are to be given their commonly accepted meaning. Thus, for example, manufacturing or production includes the construction, reconstruction, or making of property from or with scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, refining, or changing the form of an article, or (2) by combining or assembling two or more articles, and includes the cultivation of the soil and the raising of livestock and other farm produce. Section 38 property would include, for example, property used as an integral part of the extraction, processing, refining, and fabrication of minerals or mineral products; the growing, raising, processing, and packing or packaging of foodstuffs; the operation of sawmills and the production of lumber and lumber products and other building materials; and the manufacture, treatment, and packaging of textiles, paper, leather

goods, glass, etc. Examples of transportation businesses would be railroads and airlines. Examples of communications businesses would include businesses furnishing telephone and telegraph services or radio or television broadcasting stations.

In order to qualify for the credit, property (other than tangible personal property and research or storage facilities used in the specified activities) must be used as an integral part of one or more of the specified activities. Thus, for example, section 38 property would ordinarily not include such assets as pavements, parking areas, advertising displays, outdoor lighting facilities, or swimming pools which, although used as a part of the overall business operation, are not used directly in the specified activities. Specific examples of qualifying property which normally would be used as an integral part of one of the specified activities are blast furnaces, oil and gas pipelines, and railroad tracks and signals. Fences will qualify as section 38 property where used as an integral part of a specified activity as, for example, where used in connection with the raising of livestock.

Research or storage facilities (other than buildings) are eligible for the credit if used in connection with any of the specified activities, although such property is not an integral part of the activity.

Property used outside the United States

Subparagraph (A) of section 48(a)(2) provides that, subject to certain exceptions contained in subparagraph (B) of that section, the term "section 38 property" does not include property used predominantly outside the United States (as defined in sec. 7701(a)(9)). The term "predominantly outside the United States" means that the property must be physically located outside the United States more than 50 percent of the time during any one taxable year. Thus, if property is originally placed in service in the United States and a credit is received on such property, but such property is thereafter in any one year used predominantly outside the United States, such property ceases to be section 38 property with respect to the taxpayer who obtained the credit, regardless of the fact that the property is later returned to the United States. Furthermore, if property is originally placed in service by the taxpayer outside the United States and is used predominantly outside the United States during the taxable year originally placed in service, such property cannot qualify as section 38 property with respect to such taxpayer.

Subparagraph (B)(i) of section 48(a)(2) provides that any aircraft which is registered by the Administrator of the Federal Aviation Agency and which is operated, whether on a scheduled or nonscheduled basis, to and from the United States may be section 38 property even though it is used predominantly outside the United States. The term "to and from" the United States is not intended to exclude an aircraft which makes flights from one point in a foreign country to another such point, as long as such aircraft returns to the United States with some degree of frequency.

Subparagraph (B)(ii) provides that rolling stock of a domestic railroad corporation subject to part I of the Interstate Commerce Act which is used within and without the United States does not lose its eligibility for the credit even though it is used predominantly outside the United States. For the purposes of subparagraph (B)(ii)

the term "rolling stock" means locomotives, freight and passenger train cars, floating equipment, and miscellaneous transportation equipment on wheels, the expenditures for which are chargeable to the equipment investment accounts in the uniform system of accounts for railroad companies prescribed by the Interstate Commerce Commission.

Subparagraph (B)(iii) provides that any vessel which is documented under the laws of the United States and which is operated in the foreign or domestic commerce of the United States may qualify as section 38 property.

Subparagraph (B)(iv) provides that any motor vehicle of a United States person (as defined in sec. 7701(a)(30)) which is operated to and from the United States with some degree of frequency may be section 38 property even though predominantly used outside the United States.

Subparagraph (B)(v) provides that any container of a United States person which is used in the transportation of property to and from the United States may be section 38 property even though used predominantly outside the United States.

Subparagraph (B)(vi) provides that property (other than vessels or aircraft) of a United States person which is used for the purposes of exploring for, developing, removing, or transporting resources from the outer Continental Shelf of the United States (within the meaning of sec. 2 of the Outer Continental Shelf Lands Act as amended and supplemented; 43 U.S.C., sec. 1331) may be section 38 property. Thus, for example, the credit may be allowed for offshore drilling equipment.

Property used for lodging

The first sentence of paragraph (3) of section 48(a) provides that the term "section 38 property" does not include property which is used predominantly to furnish lodging or is used predominantly in connection with the furnishing of lodging. Thus, if property is used predominantly to furnish lodging in the year it is placed in service, it does not qualify as section 38 property. If property on which a credit has been allowed is used predominantly to furnish lodging in any subsequent year, such property will cease to be section 38 property. Property which is generally considered to be used to furnish lodging includes beds and other furniture and fixtures used in the accommodations for lodging.

The second sentence of section 48(a)(3) provides two exceptions to the rule excluding from the credit property used for lodging or in connection with the furnishing of lodging. Subparagraph (A) of such second sentence provides that nonlodging commercial facilities which are available to persons not using the lodging facilities on the same basis that they are available to persons using the lodging facilities may qualify for the credit. For example, tangible personal property used in a restaurant or pharmacy may qualify as section 38 property notwithstanding the fact that the restaurant or pharmacy is operated in connection with lodging facilities such as an apartment house. However, the furniture and fixtures, rugs, draperies, etc. used, for example, in the lobby of an apartment house would be excluded since they are furnished in connection with the furnishing of lodging and

since the lobby of an apartment house is not a nonlodging commercial facility.

Subparagraph (B) of the second sentence of section 48(a)(3) provides that property used by a hotel or motel in connection with the trade or business of furnishing lodging may qualify for the credit where the predominant portion of the accommodations is used by transients. Thus, if more than half of the rooms used to accommodate guests of a hotel or motel are normally used on a transient basis, the property used in such hotel or motel may qualify for the credit even though it is used in connection with furnishing lodging. Conversely, if less than half of the accommodations are normally used on a transient basis, none of the property used in the hotel or motel may qualify for the credit except for property used in connection with a nonlodging commercial facility.

Property used by tax-exempt organizations

Paragraph (4) of section 48(a) provides that property used by an organization (other than a cooperative described in sec. 521) which is exempt from the tax imposed by chapter 1 of the code shall be treated as section 38 property only if such property is used predominantly in an unrelated trade or business the income of which is subject to tax under section 511. The term "property used by" an organization exempt from tax includes property leased to such an organization, as well as property leased by such an organization to another person. Thus, if property does not qualify under section 48(a)(4) because it is leased to an organization exempt from tax, no credit is allowable to the lessor with respect to such property.

Property used by governmental units

Paragraph (5) of section 48(a) also excludes from the term "section 38 property" property used by the United States, any State (as defined in sec. 7701(a)(10) of the code) or political subdivision thereof, any international organization (as defined in sec. 7701(a)(18) of the code), or any agency or instrumentality of any of the foregoing.

(b) *New section 38 property.*—Subsection (b) of section 48 provides that, for purposes of the credit, "new section 38 property" means only section 38 property, the construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1961, or acquired by the taxpayer after that date provided the original use of such property commences with the taxpayer and commences after such date. In the case of property constructed, reconstructed, or erected by the taxpayer, there is to be taken into account in determining the basis of such property only that portion of the basis which is properly attributable to construction, reconstruction, or erection after December 31, 1961. The principles applicable under section 167(c) of the code are to be applied under section 48(b) in determining, for example, when the property is acquired by the taxpayer, whether the original use of the property commences with the taxpayer, and the portion of the basis of property completed after December 31, 1961, which is attributable to construction, reconstruction, or erection after that date.

(c) *Used section 38 property.*—Paragraph (1) of section 48(c) defines the term "used section 38 property" as section 38 property acquired by purchase after December 31, 1961, which is not new section 38 property.

Used section 38 property does not include property which, after its acquisition by the taxpayer, is used by a person who used such property before such acquisition. This rule also applies where the property after acquisition by the taxpayer is used by a person who is related to a person who used the property before acquisition. Such person will be considered as related if the relationship is one described in section 179(d)(2) (A) or (B) (as, for example, where the parties are members of an affiliated group, as defined in sec. 48(c)(3)(C)). Thus, if property were sold under a sale and leaseback arrangement, such property in the hands of the purchaser-lessor would not be used section 38 property since the property, after its acquisition, is being used by the same person who used it before the acquisition. Similarly, where a taxpayer has been leasing property, and subsequently purchases such property (whether or not the lease contained a purchase option feature), such property is not used section 38 property with respect to such taxpayer, since it is being used by the person who used such property before its acquisition. In addition, if property owned by a lessor is sold subject to a lease or is sold upon the termination of a lease, the property will not qualify as used section 38 property with respect to the purchaser, if thereafter the property is used by a lessee who used the property before the acquisition. For purposes of applying the rule contained in section 48(c)(1), property will be considered used by a person only if a substantial use is made. Thus, property would not be disqualified as used section 38 property merely because a person using the property after acquisition had also made some casual use of it before acquisition.

Dollar limitation

Under subparagraph (A) of section 48(c)(2), the cost of used section 38 property which may be taken into account under section 46(c)(1)(B) in computing qualified investment for any taxable year is not to exceed \$50,000. If the total cost of used section 38 property placed in service during the taxable year exceeds \$50,000, the taxpayer must select the particular assets he wishes to be taken into account in computing qualified investment (but not to exceed an aggregate cost of \$50,000). The selection of the specific assets to be taken into account is to be made at the time and in the manner prescribed by regulations. Such selection may be changed only in the manner and to the extent provided by the regulations. Thus, if a taxpayer has a cost of used section 38 property of \$25,000 acquired in connection with the operation of a sole proprietorship, \$30,000 allocated to him from a subchapter S corporation, and \$20,000 which is his share of the cost of used section 38 property acquired by a partnership of which he is a member, he may select from the total of \$75,000 the particular assets which he wishes to take into account for purposes of computing qualified investment. If the assets selected all have useful lives of between 4 and 6 years, the maximum qualified investment in used section 38 property will be \$16,667. If the assets selected all have useful lives in excess of 8 years, qualified investment in used section 38 property would be \$50,000.

Subparagraph (B) of section 48(c)(2) provides that in the case of a husband or wife filing a separate return, the cost of used section 38 property that may be taken into account is not to exceed \$25,000. If this subparagraph applies, and such cost exceeds \$25,000, the

husband or wife may select, under regulations prescribed by the Secretary of the Treasury or his delegate, the assets to be taken into account, but only to the extent of an aggregate cost of \$25,000. Subparagraph (B) shall apply, however, only if the spouse of the taxpayer has purchased (or has been allocated) used section 38 property which may be taken into account in qualified investment for the taxable year of such spouse which ends within or with the taxpayer's taxable year. Thus, if both husband and wife have purchased (or have been allocated) any used section 38 assets for the taxable year (as described above) and they file separate returns, the maximum cost of used section 38 property which may be taken into account by each is \$25,000; but if only one spouse has purchased (or has been allocated) any used section 38 assets, such spouse may take into account \$50,000 of the cost of used section 38 property.

Subparagraph (C) of section 48(c)(2) provides that in the case of an affiliated group, the \$50,000 limitation is to be reduced for each member of the group by apportioning the \$50,000 limitation among the members of the affiliated group in accordance with their respective amounts of used section 38 property which may be taken into account. The phrase, "their respective amounts of used section 38 property which may be taken into account", has reference to the total cost of used section 38 property without regard to the \$50,000 limitation or the applicable percentages to be applied in computing qualified investment. An affiliated group is one defined in section 1504(a) except that the phrase "more than 50 percent" is to be substituted for the phrase "at least 80 percent" each place it appears in section 1504 (a), and all corporations are to be treated as includible corporations. Thus, even if a corporation is excluded under section 1504(b) from being a member of an affiliated group for purposes of filing a consolidated return, it nevertheless will be treated as an includible corporation for purposes of section 48(c).

Subparagraph (D) of section 48 (c)(2) provides that, in the case of partnerships, the limitation on the amount of used section 38 property which may be taken into account is to apply both with respect to the partnership and with respect to each partner. Thus, a partnership will be limited to used section 38 property having a cost of \$50,000 regardless of the number of partners.

If the aggregate cost of used section 38 property purchased by the partnership during a taxable year exceeds \$50,000, the partnership, under regulations prescribed by the Secretary of the Treasury or his delegate, is to select the properties, the cost of which is to be taken into account by the partners. Each partner will then combine his share of the cost of the used section 38 property selected by the partnership with the cost of any other used section 38 property to which he may be entitled. This combined amount may not exceed \$50,000 (or \$25,000 in the case of certain married individuals under section 48(c)(2)(B)). If such amount exceeds \$50,000, the taxpayer will then select the properties to which the applicable percentages are to be applied in computing his qualified investment.

Definitions

Subparagraph (A) of section 48(c)(3) provides that the principles of section 179(d)(2) of the code are to be applied in determining whether the property has been acquired by purchase. Thus, for

example, used section 38 property is not acquired by purchase if it is acquired from a person whose relationship to the person acquiring it would result in the disallowance of a loss under section 267 or 707(b) (except that in applying sec. 267 (b) and (c), the family of an individual includes only his spouse, ancestors, and lineal descendants, and not his brothers and sisters). Furthermore, the term "purchase" does not include the acquisition of property by one member of an affiliated group (as defined in sec. 48(c)(3)(C)) from another member of the same affiliated group, or the acquisition of property the basis of which is determined in whole or in part by reference to the adjusted basis in the hands of the person from whom acquired, or under 1014(a) (relating to property acquired from a decedent).

Subparagraph (B) of section 48(c)(3) provides that the cost of used section 38 property does not include so much of the basis of such property as is determined by reference to the adjusted basis of other property held at any time by the person acquiring such property. Thus, for example, if the basis of used section 38 property acquired is determined under section 1031 (relating to certain nontaxable exchanges), the preceding rule applies. In addition, if property is disposed of and used section 38 property which is similar or related in service or use is acquired as a replacement therefor (whether before or after the disposition), in a transaction to which the preceding rule does not apply, the cost of the used section 38 property acquired is the basis of such property, reduced by the adjusted basis of the property replaced. In such a case, if the basis of the replacement asset is \$2,000 and the adjusted basis of the replaced asset is \$1,200 at the time of its disposition, the cost of used section 38 property would be \$800. Notwithstanding the rules described in this paragraph, the cost of used section 38 property is not to be reduced by the adjusted basis of any property disposed of if by reason of section 47 the disposition of such property gives rise to an increase of tax or a reduction of unused credit carryovers.

(d) *Certain leased property.*—Subsection (d) of section 48 provides that in certain cases where property is leased to another by a person engaged in the business of leasing property, such person may elect to treat the lessee as having acquired such property. This rule applies only with respect to property which is new section 38 property in the hands of the lessor. Thus, for example, the election may not be made with respect to property owned by an organization exempt from tax unless the property is used predominantly in an unrelated trade or business of leasing, the income of which is subject to tax under section 511.

In addition, the election may be made only with respect to the first lessee of such new section 38 property, and only if such property would constitute new section 38 property if such lessee had actually acquired the property. Thus, for example, the election cannot be made if the first lessee uses the property predominantly outside the United States.

Also, for purposes of determining whether such property would constitute new section 38 property if purchased by the lessee, the original use of the property will be deemed to commence with the first lessee if he is the first person to use such property for its intended function. Thus, the fact that the lessor may have, for example, tested, stored, or attempted to lease the property to other persons will not preclude the lessee from being deemed the original user as

long as neither the lessor nor any other person has physically used the property for its intended function before its use by the lessee. Moreover, in determining whether the property qualifies as new section 38 property to the lessee and in determining the amount of his qualified investment with respect to such property, the estimated useful life of the property to the lessee will be deemed to be the estimated useful life in the hands of the lessor. The election is not available if the lessor is a person referred to in section 46(d); i.e., a mutual savings bank, cooperative bank, or domestic building and loan association to which section 593 applies; a regulated investment company or real estate investment trust subject to taxation under subchapter M; or a cooperative organization described in section 1381(a).

If the election is made, the lessee will be treated for all purposes of subpart B as though he had acquired the property. Thus, if the leased property is disposed of by the lessee, or if it otherwise ceases to be section 38 property to him, such property will be subject to the provisions of section 47 applicable to such cessations. Also, if the first lessee of property is treated as having acquired such property, the lessor is thereafter precluded from obtaining a credit as to such property. The election under section 48(d) will be made at such time, in such manner, and subject to such conditions as may be provided in regulations prescribed by the Secretary of the Treasury or his delegate.

In any case in which the lessee is treated as having acquired the property, the lessee's investment is deemed to be equal to the fair market value of the property if such property is constructed by the lessor or by a corporation which controls or is controlled by the lessor within the meaning of section 368(c). In any other case the lessee's investment is the basis of the property in the hands of the lessor.

The provisions of section 48(d) may be illustrated by the following example:

X corporation is engaged in the business of manufacturing and leasing new and reconditioned equipment which in its hands has an estimated useful life of 8 years. After December 31, 1961, X corporation constructs machine No. 1, having a fair market value of \$15,000 and a cost of \$10,000, and reconditions machine No. 2 at a cost of \$5,000. Y corporation leases both machines from X immediately after their construction and reconditioning and before X has made any other use of such machines. As to machine No. 1, if X elects to treat the property as being acquired by Y, such machine will have a basis of \$15,000 in Y's hands, and an estimated useful life of 8 years, for purposes of determining qualified investment (assuming the property otherwise qualifies as new section 38 property in Y's hands). The election is not available with respect to machine No. 2, since a reconditioned machine would not constitute new section 38 property if the lessee had purchased it. In such a case, while X corporation cannot make the election to let the Y corporation take the credit, X corporation would be entitled to a credit based on its expenditure of \$5,000 as an investment in new section 38 property, the reconstruction of which is completed after December 31, 1961.

(e) *Subchapter S corporations.*—Subsection (e) of section 48 provides for the application of the credit in the case of an electing small business corporation under subchapter S. The qualified investment of the subchapter S corporation is allocated pro rata among the

persons who are shareholders on the last day of the corporation's taxable year. The qualified investment is ascertained at the corporate level, and thus the aggregate cost of used section 38 property that may be allocated to the shareholders is limited to \$50,000. If the cost of used section 38 property purchased by the subchapter S corporation exceeds \$50,000 in any one taxable year, the corporation is to select, under regulations prescribed by the Secretary of the Treasury or his delegate, the properties the cost of which may be taken into account by its shareholders.

Any person to whom an investment is apportioned under subsection (e) of section 48 is to be treated as the taxpayer with respect to such investment, and such investment will not (by reason of such apportionment) lose its character in his hands as an investment in either new or used section 38 property. Thus, each shareholder will take into account, in determining his own qualified investment, his allocated share of the corporation's qualified investment in new section 38 property. He will also take into account his allocated share of the corporation's investment in used section 38 property. Of course, since only \$50,000 cost of used section 38 property may be taken into account, if a shareholder's combined cost of used section 38 property exceeds \$50,000, he must select the properties to be taken into account in computing his qualified investment.

If a shareholder includes in his qualified investment any portion of the basis or cost of property acquired by the subchapter S corporation and the corporation subsequently disposes of such property, or if the shareholder disposes of his stock in such corporation, the shareholder will be subject to the provisions of section 47 with respect to such property.

(f) *Estates and trusts*.—Subsection (f) of section 48 provides rules for applying the investment credit to estates and trusts. Paragraph (1) of section 48(f) provides that the qualified investment for any taxable year is to be apportioned between the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each. The qualified investment is ascertained at the trust or estate level, and thus the aggregate cost of used section 38 property that may be apportioned between the estate or trust and the beneficiaries is limited to \$50,000. If the cost of used section 38 property purchased by the estate or trust exceeds \$50,000 in any one taxable year, the estate or trust is to select, under regulations prescribed by the Secretary of the Treasury or his delegate, the properties the cost of which may be taken into account.

Paragraph (2) of section 48(f) provides that any beneficiary to whom the investment is apportioned is to be treated as the taxpayer with respect to such investment, and such investment will not (by reason of such apportionment) lose its character as an investment in either new or used section 38 property. If the combined cost of used section 38 property available from all sources to any beneficiary exceeds \$50,000, such beneficiary must select the properties the cost of which is to be taken into account in computing his qualified investment. The term "beneficiaries" as used in section 48(f) includes heirs, legatees, and devisees.

Paragraph (3) of section 48(f) provides that the \$100,000 amount specified under subparagraphs (A) and (B) of section 46(a)(2) applicable to such estate or trust is to be reduced to an amount which

bears the same ratio to \$100,000 as the amount of the qualified investment allocated to the estate or trust under paragraph (1) of section 48(f) bears to the entire amount of the qualified investment. Thus, in a case where the qualified investment of the estate or trust is \$1 million, and \$250,000 of such amount is allocated to the estate or trust because 25 percent of the income is allocable to the estate or trust, the \$100,000 amount in the case of such estate or trust is reduced to \$25,000.

SECTION 2. CREDIT FOR INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY (Continued)

(c) *Certain corporate acquisitions.*—Subsection (c) of section 2 of the bill provides an amendment to section 381(c) of the 1954 Code (relating to the carryover of tax attributes in the case of certain corporate acquisitions) by adding paragraph (23) thereto. Section 381(c)(23) provides that the acquiring corporation is to take into account (to the extent proper to carry out the purposes of sec. 381 and sec. 38, and under such regulations as may be prescribed by the Secretary of the Treasury or his delegate) the items required to be taken into account for purposes of section 38 in respect of the distributor or transferor corporation. Thus, for example, the regulations under section 381(c)(23) will provide rules for the carryover of any unused credit carryovers of the distributor or transferor corporation and for the application of section 47 to dispositions by the acquiring corporation of property acquired from the distributor or transferor corporation.

(d) *Clerical amendment.*—Subsection (d) of section 2 of the bill provides a clerical amendment to part IV of subchapter A of chapter 1 of the 1954 Code.

(e) *Effective date.*—Subsection (e) of section 2 of the bill provides that the amendments made by section 2 of the bill are to apply with respect to taxable years ending after December 31, 1961.

SECTION 3. APPEARANCES, ETC., WITH RESPECT TO LEGISLATION

(a) *In general.*—Subsection (a) of section 3 of the bill amends section 162 (relating to trade or business expenses) by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) a new subsection (e) relating to appearances, etc., with respect to legislation.

Paragraph (1) of the new subsection (e) provides that the deduction allowed by subsection (a) of section 162 is to include all of the following ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business: (1) expenses in direct connection with appearances before, submission of statements to, or sending communications to, the committees, or individual members, of Federal, State, or local legislative bodies with respect to legislation or proposed legislation of direct interest to the taxpayer, (2) expenses in direct connection with communication of information between the taxpayer and an organization of which he is a member with respect to legislation or proposed legislation of direct interest to the taxpayer and to such organization, and (3) that portion of dues

with respect to any organization of which the taxpayer is a member which is attributable to the expenses of the activities above described in this paragraph which are carried on by such organization. Paragraph (1) also provides that the expenses referred to therein are to include, but not be limited to, the cost of preparing testimony and traveling expenses described in subsection (a)(2) of section 162.

Paragraph (2) of the new subsection (e) provides that the provisions of paragraph (1) are not to be construed as allowing the deduction of any amount paid or incurred (whether by way of contribution, gift, or otherwise)—

(1) for participation in, or intervention in, any political campaign on behalf of any candidate for public office, or

(2) in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums.

(b) *Effective date.*—Subsection (b) of section 3 of the bill provides that the amendments made by subsection (a) are to apply to taxable years beginning after December 31, 1962.

SECTION 4. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES

(a) *Denial of deduction.*—Subsection (a) of section 4 of the bill adds to part IX of subchapter B of chapter 1 of the code (relating to items not deductible in computing taxable income) a new section 274.

SECTION 274. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES

Section 274 provides generally that certain expenses deductible in full under present law will be partially or completely disallowed for purposes of chapter 1 of subtitle A. Since section 274 is a disallowance provision exclusively, no expense would become deductible by reason of its enactment. In other words, the tests for deductibility under provisions of existing law (such as secs. 162, 165, 167 and 212) must first be met before the provisions of section 274 become operative. In addition, subsection (c) (relating to substantiation) of the new section 274 must be applied before determining the extent to which an expense or other item is disallowed under subsection (a) or (b) of section 274.

(a) *Entertainment, amusement, or recreation.*—

Activity.—Paragraph (1)(A) of subsection (a) of new section 274 provides that no deduction otherwise allowable under chapter 1 of the 1954 Code is to be allowed for any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless the taxpayer establishes that the item was directly related to the active conduct of his trade or business. Such deduction in no event is to exceed the portion of such item directly related to the active conduct of the taxpayer's trade or business.

Examples of "entertainment, amusement, or recreation" are entertaining guests at night clubs, country clubs, theaters, football games, and prizefights, and on hunting, fishing, vacation, and similar trips. In addition, "entertainment" includes satisfying the personal, living,

or family needs of any individual (which would otherwise constitute a business expense to the taxpayer) such as the furnishing of food and beverages, a hotel suite, or an automobile. By referring to an activity which "is of a type generally considered to constitute" entertainment, amusement, or recreation, the subsection provides an objective test for determining whether an activity falls within the proscribed category. This test makes irrelevant such arguments as, e.g.—that an essentially recreational activity, like sailing a yacht, is hard work and not recreation insofar as any particular taxpayer is concerned.

However, the taxpayer's business is to be considered in applying this objective test. For example, with respect to a taxpayer who is a professional hunter, a hunting trip generally would not be considered a recreation-type activity. On the other hand, with respect to a taxpayer whose trade or business consists of selling machine tools, manufacturing clothing, or rendering legal services, a hunting trip generally would be considered a recreation-type activity.

To further illustrate this objective test, a theatrical performance generally would be considered, with respect to most taxpayers, an entertainment-type activity. In the case of a professional theater critic, however, viewing a theatrical performance generally would not be considered to constitute entertainment. Another example of the role played by the taxpayer's business in determining the type of an activity would be in connection with a fashion show. If the taxpayer conducting the fashion show is the manufacturer of the dresses shown and the viewers are a group of store buyers, the show generally would not be considered to constitute entertainment, because the fashion show is, for a dress manufacturer, a method for introducing his product to the market. However, if the taxpayer conducting the fashion show is an appliance distributor and the viewers are the retailers and their wives, the fashion show generally would be considered to constitute entertainment.

An exception to the disallowance of entertainment-type expenses is made in paragraph (1)(A) for expenses therein described which the taxpayer establishes are directly related to the active conduct of his trade or business. Among other things, the taxpayer will have to show more than a general expectation of deriving some income at some indefinite future time from the making of the entertainment-type expenditure. However, a taxpayer will not be required to show that income actually resulted from each and every expenditure for which a deduction is claimed.

If the expenditure is for entertainment which occurs under circumstances where there is little or no possibility of conducting business affairs or of carrying on negotiations or discussions relating thereto, the expenditure generally will not be considered to be directly related to the active conduct of business. Thus, the absence of the taxpayer or his representative from the entertainment activity ordinarily indicates that the entertainment is not directly related to the active conduct of the taxpayer's trade or business. Similarly, if the group of persons entertained is large or the distractions substantial, the cost of the entertainment will not be deductible, in the absence of a showing of a direct relationship to the active conduct of the business. All the facts and circumstances pertaining to the entertainment activity will be considered in this connection. Thus, expenses incurred for a "hos-

pitality room", at a convention, at which goodwill is created through display or discussion of the taxpayer's products, will be treated as directly related.

Where a taxpayer's trade or business consists of promoting the interest of another person—such as an independent sales agent for a manufacturer, a public relations corporation, an attorney representing a client, or an employee representing his employer—an expense for an entertainment-type activity made with respect to promoting such other person's interest will not come within the exception for expenses directly related to the active conduct of a trade or business unless the taxpayer establishes the same close connection between the expenditure and such other person's trade or business or other income-producing activity as such other person would have to establish in order to come within the exception. Thus, to come within the exception, it clearly will not suffice for such taxpayer to establish that the making of such expenditure was necessary in order to enable him to continue in the service of such other person.

Paragraph (1) further provides that a deduction for an item with respect to entertainment-type activities is not to exceed the portion of such item directly related to the active conduct of the taxpayer's trade or business. This provision permits apportionment of an expense as between its business-connected and personal aspects according to objective standards.

Facilities.—Paragraph (1)(B) of subsection (a) of new section 274 provides that no deduction otherwise allowable under chapter 1 of the code is to be allowed for any item with respect to a facility used in connection with an activity generally considered to constitute entertainment, amusement, or recreation, unless the taxpayer establishes (1) that the facility was used primarily for the furtherance of his trade or business, and (2) that the item was directly related to the active conduct of his trade or business. Such deduction in no event is to exceed the portion of such item directly related to the active conduct of the taxpayer's trade or business. The same tests for determining whether an item is directly related to the active conduct of a trade or business apply as in the case of an item under paragraph (1)(A).

The term "facility" includes any item of personal or real property owned or rented by the taxpayer, such as a yacht, hunting lodge, fishing camp, swimming pool, tennis court, bowling alley, automobile, airplane, apartment, hotel suite, dining room, and cafeteria. In addition to the items more commonly regarded as "expenses" for entertaining, discussed above, paragraph (1)(B) also relates to other items, such as depreciation and losses realized on certain sales.

Under paragraph (1)(B), in addition to the requirement that the item be directly related to the active conduct of the taxpayer's trade or business, the facility must be used primarily for the furtherance of the taxpayer's trade or business. Thus, if a facility is used more than one-half for business entertaining, so that more than one-half of the entertainment expense with respect to such facility would be deductible as a business expense under present law, that portion is still to be deductible to the extent it meets the test of being directly related to the active conduct of the taxpayer's trade or business. If less than one-half of such entertainment expense would be deductible under present law, no deduction is to be allowed. In connection with these

determinations, objective rather than subjective standards are to be employed.

Paragraph (2) of subsection (a) of new section 274 prescribes two special rules for purposes of applying paragraph (1). All dues and fees paid to any social, athletic, or sporting club or organization will be treated as items with respect to a facility used for entertaining. Thus, only if the taxpayer uses a country club to which he belongs primarily for the furtherance of his business will a deduction be allowed for dues or fees paid to such club, and then only to the extent that such use is directly related to the active conduct of his business. In addition, in applying paragraph (1) an activity described in section 212 (relating to expenses for the production of income) is to be treated as a trade or business.

(b) *Gifts*.—Generally, subsection (b)(1) of new section 274 disallows all expenses for gifts to individuals in excess of a cumulative total of \$25 per year per recipient. The reference to “indirect” gifts in this subsection includes situations where the gift is intended for the eventual use or benefit of an individual but is made initially to his corporation or to some member of his family. The term “gift”, for purposes of section 274, has the same meaning as it does under section 102 of the code (relating to the exclusion of gifts and inheritances from gross income).

Any item which is excludable from gross income under a provision of chapter 1 of the code other than section 102 is not a “gift” within the meaning of subsection (b)(1). To illustrate the applicability of subsection (b)(1), a payment by an employer to a deceased employee’s widow which is excludable from her income by reason of the gift exclusion provision, section 102, will not be deductible by the employer in excess of \$25, whereas the treatment by an employer of a payment to a deceased employee’s widow which constitutes an employee’s death benefit excludable by the recipient under section 101(b) of the code will not be affected by this provision. As another example, amounts received by an individual as a scholarship which are excludable from the individual’s gross income under section 117 of the code are not “gifts” within the meaning of this subsection. Similarly, those prizes and awards which are excludable from an individual’s gross income under section 74(b) of the code are not “gifts” within the meaning of this subsection.

Since the question in subsection (b)(1) is what portion of the taxpayer’s expense will be disallowed, the \$25 amount necessarily relates to the taxpayer’s cost rather than to the value of the property to the donee. However, certain incidental costs, such as packaging, insurance, and mailing or other delivery, will be disregarded in determining whether the \$25 limit has been exceeded.

There is a possibility of overlapping application of subsections (a) and (b), since some items can reasonably be classified both as gifts and as entertainment. Different rules under section 274 apply depending on the classification of the item. As described in greater detail below, the express authority given to the Secretary of the Treasury or his delegate to prescribe regulations will be used to solve these problems of classification so as to clarify and make more certain the application of section 274.

Subsection (b)(2) prescribes two special rules for applying subsection (b)(1). Under subsection (b)(2)(A), in the case of a gift by a

partnership (including a gift made by a partner with respect to the business of the partnership), the \$25 limitation will be applied at the partnership level, as well as at the level of the individual partner. Thus deductions for gifts made with respect to partnership business will not exceed \$25 per recipient, regardless of the number of partners.

Under subsection (b)(2)(B), a husband and wife are for purposes of subsection (b)(1) treated as one "taxpayer". Thus, in the case of a gift by a husband and wife, the spouses will be treated as one donor. However, since "taxpayer" in subsection (b)(1) refers only to the donor of a gift, this special rule does not pertain to gifts, for example, made by an individual to a husband and wife who are partners in a business.

(c) *Substantiation required.*—Subsection (c) of the new section 274 imposes another limitation on traveling expenses deductible under section 162(a)(2) or 212, on items with respect to activities described in subsection (a) as entertainment, amusement, or recreation, or with respect to facilities used in connection therewith (whether or not excepted from the application of subsec. (a) of sec. 274 by subsec. (d)), and on expenses for gifts. Subsection (c) overrules with respect to the described expenditures the case of *Cohan v. Commissioner*, 39 F. 2d 540 (C.A. 2d 1930). That case held that where evidence indicates that a taxpayer has incurred deductible travel or entertainment expenses but their exact amount cannot be determined, the court must make "as close an approximation as it can" and not disallow the deduction entirely. Under subsection (c) approximations of the type which under the *Cohan* doctrine have been sufficient to entitle the taxpayer to a deduction will no longer have that effect. In other words, if the taxpayer fails to substantiate an item as required by subsection (c) and the regulations thereunder, the item will be completely disallowed.

Subsection (c) provides that no deduction is to be allowed for the above-described items unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his own statement the following: the amount of such expense or other item; the time and place of the travel, entertainment, amusement, recreation, or use of the facility, or the date and description of the gift; the business purpose of the expense or other item; and the business relationship to the taxpayer of the persons entertained, using the facility, or receiving the gift. The taxpayer's records or corroborating evidence must pertain to separate expenses or other items of deduction, not to aggregate amounts.

Generally, a clear, contemporaneously kept diary, account book, or similar record containing the information specified in subsection (c) will be an adequate record within the meaning of this subsection. However, receipts, cancelled checks, paid bills, stubs, or other similar records may be required in certain cases, as, for example, to substantiate the amount expended for lodging and transportation while traveling on business. Thus, the taxpayer may be required to preserve hotel bills or transportation receipts to substantiate such items by adequate records. In order to avoid hardship, a reasonable reconstruction of expenditures will be accepted in those cases where the absence of records is due to circumstances beyond the taxpayer's control, such as destruction by fire, flood, or other casualty.

Where the taxpayer fails to maintain adequate records with respect to any of the described aspects of an expense, that aspect must be substantiated by the taxpayer's own statement corroborated by sufficient evidence. The taxpayer's own uncorroborated statement will not constitute substantiation with respect to any such aspect. The evidence required may vary with respect to each aspect of an item claimed as a deduction. Thus, circumstantial evidence, such as the nature of the business activities of the taxpayer and of the person entertained, may be sufficient to corroborate the taxpayer's statement regarding business purpose and business relationship, whereas more direct evidence, such as the testimony of witnesses, will be required to substantiate amount, time, place, date and description.

Under subsection (c), the Secretary of the Treasury or his delegate is authorized to provide by regulations that some or all of the requirements of subsection (c) are not to apply in the case of an expense which does not exceed an amount determined under such regulations. Thus, the regulations could provide that a fixed scale of allowance for mileage or per diem in lieu of subsistence based upon reasonable business practices, will be acceptable in lieu of detailed substantiation. Similarly, the regulations could prescribe an exception for *de-minimis* expenses.

(d) *Exceptions to application of subsection (a).*—Subsection (d) of the new section 274 contains nine exceptions to the general rule of section 274(a). These exceptions are to the disallowance provision of subsection (a) exclusively. The fact that an item is not covered by one of the nine exceptions does not mean that *ipso facto* it will be disallowed under subsection (a). It is to be emphasized that the new section 274(d) in no way changes existing law with respect to the disallowance of expenses by reason of failure to meet the "ordinary and necessary" test in section 162 or 212 of the code. Furthermore, the substantiation requirements of subsection (c) also must be fulfilled with respect to the items covered by these exceptions.

Paragraph (1) excepts from the disallowance prescribed in subsection (a)(1) expenses for food and beverages furnished under circumstances which are of a type generally considered to be conducive to a business discussion, taking into account the surroundings in which furnished, the taxpayer's trade, business, or income-producing activity, the relationship to such trade, business, or activity of the persons to whom the food and beverages are furnished, and any other relevant facts. There is no requirement in this exception that business actually be discussed. Thus, if the described circumstances are established, and if the amounts are deductible under section 162 or 212 and are substantiated as required under section 274(c), the expenses for food and beverages will be deductible even where the making of the expenditure merely promotes goodwill.

Generally, a night club or other place where entertainment is a major attraction would not be considered a suitable environment for a business discussion. Similarly, any sizable social gathering, such as a large cocktail party, would afford little opportunity for quiet business talk and ordinarily would not be considered circumstances conducive to a business discussion. However, a dinner which is part of a formal business program will generally be regarded as a circumstance conducive to a business discussion.

Paragraph (2) relates to food and beverages furnished on the taxpayer's business premises. By reason of this exception, no expense for food and beverages furnished on the business premises primarily to employees of the taxpayer will be disallowed under section 274(a). In addition, expenses for food and beverages furnished to nonemployee business guests will be deductible if furnished in a dining room which is primarily for the taxpayer's employees and is located on the taxpayer's business premises. Paragraph (2) also excepts from disallowance expenses for facilities to the extent they are used in connection with furnishing the above-described food and beverages. The exception provided by paragraph (2) applies to both the typical company cafeteria and meals furnished to employees because their presence on the job at all times is essential.

The exception in paragraph (3) applies to expenses for goods, services and facilities to the extent that the expense is properly treated by the taxpayer, with respect to the recipient of the entertainment, amusement, or recreation, as compensation paid to an employee on the taxpayer's income tax return and as "wages" for purposes of withholding. Thus, a taxpayer rewarding a key employee with a vacation trip would not be disallowed the expenses under section 274(a) if the taxpayer treated the expenses as wages for withholding purposes and deducted them on his income tax return as compensation paid to the key employee. Salary paid to the captain of a yacht used for business entertaining does not come within this exception.

If an expense properly constitutes a dividend to a shareholder, or if it constitutes unreasonable compensation to an employee, the exception in paragraph (3) will not prevent its disallowance.

Paragraph (4) excepts from disallowance with respect to the taxpayer certain expenses paid or incurred by the taxpayer in connection with the performances by him of services for another person (whether or not such other person is the taxpayer's employer) for which the taxpayer is reimbursed by such other person under a reimbursement or other allowance arrangement. This exception prevents the double disallowance of a single expenditure, once with respect to the person who actually bears the expense and benefits from it and once with respect to the person who pays the expense on behalf of the first person and is reimbursed therefor. However, two qualifications are provided which insure that a described expense will be disallowed at one level. If the services are performed by a taxpayer, who is an employee, for his employer, and if the employer treats the expense as compensation paid to the employee and it falls within the scope of the subsection (d)(3) exception, the subsection (d)(4) exception does not apply. If the services are performed by the taxpayer for a person who is not the taxpayer's employer, the subsection (d)(4) exception does not apply unless the taxpayer accounts to such other person by means of records or other sufficient evidence which would satisfy the substantiation requirement of subsection (c). The term "reimbursement or other expense allowance arrangement" is derived from section 62(2)(A) of the code and has the same meaning in section 274(d) (without regard to whether the taxpayer is the employee of the person for whom services are performed) as it does in that section.

Paragraph (5) provides an exception for expenses for recreational, social, or similar activities which are primarily for the benefit of the

employees of the taxpayer. This exception applies to the usual employee fringe benefit programs. For example, the expenses of operating a company bowling alley or swimming pool which is available to all employees generally will be deductible. Similarly, the costs of the office Christmas party or summer outing generally will be deductible.

In order to exclude from this exception benefits primarily for executives and owners of closely held businesses, the exception applies only with respect to activities which are primarily for employees other than employees who are officers, shareholders, or other owners who own a 10-percent or greater interest in the business, or highly compensated employees. In determining whether an employee owns a 10 percent or greater interest in the business, the employee is to be treated as owning any interest owned by a member of his family (within the meaning of sec. 267(c)(4)).

Paragraph (6) provides an exception for expenses directly related to business meetings of employees or stockholders. This exception pertains only to meetings which are principally for the discussion of business. To illustrate, a meeting of employees for the principal purpose of introducing them to and instructing them with respect to a new procedure for conducting the employer's business would be considered a business meeting. Similarly, a regular annual meeting of stockholders for the election of directors and discussion of corporate affairs would be considered a business meeting. A convention of employees for the principal purpose of rewarding them for their outstanding performance of services for their employer would not be considered a business meeting. However, such a convention might come within the scope of paragraph (3) or (5).

Paragraph (7) pertains to expenses directly related and necessary to attendance at business meetings or conventions of exempt section 501(c)(6) organizations. It is similar to the exception in paragraph (6), except that it relates only to attendance at meetings, or conventions of business leagues, chambers of commerce, real-estate boards, or boards of trade which are exempt from tax under section 501(a) and it is not limited in application to attendance by employees or stockholders.

Paragraph (8) pertains to goods and services (including the use of facilities) which are made available by the taxpayer to the general public. By reason of this exception, expenses for entertainment of the general public by means of television, radio, newspapers, and the like will continue to be deductible under section 162. Similarly, a deduction may still be claimed under section 162 for the expense of maintaining private parks, golf courses, and similar facilities, to the extent that they are available for public use. For example, if a corporation maintained a swimming pool for the use of its executive officers and their guests but during the summer months made the pool available for a period of time each week to the children participating in the local public recreation program, the portion of the expenses relating to such public use of the pool would come within this exception.

Paragraph (9) is designed to insure that no expense will be disallowed under subsection (a) if it is for goods or services which are sold by the taxpayer in a bona fide transaction for an adequate and full consideration in money or money's worth. Thus, the cost of producing night club entertainment for sale to customers will not be

disallowed. Similarly, the cost of operating a pleasure cruise ship as a business will not be disallowed.

The last sentence in subsection (d) makes it clear that the "expenses" to which paragraphs (1) through (9) relate include such items as depreciation and losses.

(e) *Interest, taxes, casualty losses, etc.*—Subsection (e) excepts from the provisions of section 274 items which would constitute allowable deductions for an individual taxpayer regardless of whether he was engaged in any trade or business. Examples of such items are interest, taxes such as real property taxes, and casualty losses. Thus, if a taxpayer owned a fishing camp, he could still deduct mortgage interest and real property taxes in full even if its use was not primarily for the furtherance of the taxpayer's trade or business.

(f) *Treatment of entertainment, etc., type facility.*—This subsection prescribes the treatment to be accorded facilities coming within the purview of subsection (a)(1)(B), for purposes of chapter 1 generally. To the extent that expenses and other items with respect to a facility are disallowed under subsection (a), that portion of the facility is to be accorded the treatment provided under present law to an asset used exclusively for personal, living, and family purposes. Thus, the portion of a facility so treated will not be subject to depreciation, and losses incurred on the sale of such portion will not be deductible.

(g) *Regulatory authority.*—Subsection (g) authorizes the Secretary of the Treasury or his delegate to prescribe such regulations as he deems necessary to carry out the purposes of section 274. For example, under this authorization rules will be prescribed for determining whether subsection (a) or subsection (b) applies to an expenditure to which both subsections might be considered to apply. Items are to be given the character ascribed to them by the public generally and without regard to the revenue consequences of the characterization. In addition, the Secretary of the Treasury or his delegate is required to prescribe rules for determining whether section 274 (a) or (b) applies with respect to an expenditure which could also be described as falling solely within the purview of some other section. This overlap problem will be resolved by ascribing to the expenditure a character which carries out the purposes of section 274. If the item confers a personal benefit in the form of entertainment, amusement, recreation or a personal, living or family need of the individual it will be treated as a section 274 item.

The problem of the overlap of subsections (a) and (b) of section 274 can be illustrated by a case where a taxpayer provides one of his customers with tickets to an amusement event. Here both the entertainment and gift provisions might apply. Under the regulations the entertainment provision always will apply with respect to such theater tickets regardless of whether the taxpayer accompanies the customer to the theater or sends him the tickets. On the other hand, gifts of a chattel such as a book or a toy will be classified as a gift, coming within the purview of subsection (b), even though the use of the item results in the entertainment of the recipient. Packaged food and beverages will be treated as gifts, while food and beverages consumed at meals will be considered entertainment.

The problem of properly characterizing an expenditure for purposes of determining whether section 274 is applicable, or whether the expenditure is to be treated solely under some other section, can be illustrated by a case where a taxpayer distributes to each of his cus-

tomers a valuable gift which is inscribed with the taxpayer's name. Expenditures for such items might be characterized as advertising expenses or as expenses for gifts. Under the regulations, expenditures for such items will be characterized as gifts.

SECTION 4. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES (Continued)

(b) *Traveling expenses.*—Subsection (b) of section 4 of the bill amends section 162(a)(2) of the 1954 Code (relating to traveling expenses while away from home) by striking out the existing provision under which the entire amount expended for meals and lodging is included in the allowable deduction and substituting therefor a provision under which there is to be included a reasonable allowance expended for meals and lodging.

(c) *Effective date.*—Subsection (c) of section 4 of the bill provides that the amendments made by section 4 are to apply with respect to taxable years ending after June 30, 1962, but only with respect to periods after such date.

SECTION 5. AMOUNT OF DISTRIBUTION WHERE CERTAIN FOREIGN CORPORATIONS DISTRIBUTE PROPERTY IN KIND

(a) *Amount distributed.*—Subsection (a) of section 5 of the bill amends section 301(b)(1) (relating to amount distributed to corporate distributees) of the 1954 Code by adding at the end thereof a new subparagraph (C). The general rule in new subparagraph (C) provides that for purposes of section 301 the amount of a distribution of property (other than money) received by a corporate shareholder from a foreign corporation will be the fair market value of such property.

An exception to the general rule is provided in cases where a dividends received deduction is allowable under section 245 with respect to such a distribution. In such a case, the amount to be taken into account (for purposes of sec. 301 of the code) with respect to property other than money is the sum, determined under regulations prescribed by the Secretary of the Treasury or his delegate, of the amounts computed under subparagraphs (C)(i) and (C)(ii). The amount under subparagraph (C)(i) is that proportion of the lesser of—

(1) the fair market value of such property, or

(2) the adjusted basis (in the hands of the distributing corporation immediately before the distribution) of such property,

which is properly attributable to gross income from sources within the United States. The amount under subparagraph (C)(ii) is that proportion of the fair market value of such property which is properly attributable to gross income from sources without the United States.

The application of subparagraph (C) may be illustrated by the following example involving corporation X, a domestic corporation which owns 100 percent of the outstanding stock of corporation Y, a foreign corporation. Corporation Y, which makes its return on the basis of the calendar year, has earnings and profits of \$200,000 for 1963 and derives 60 percent of its gross income from sources within the

United States during 1963. For an uninterrupted period of 36 months ending with the close of 1963, corporation Y has been engaged in trade or business within the United States and has derived 50 percent or more of its gross income from sources within the United States. Assume that the only distribution made by corporation Y during 1963 is a distribution of property which has a fair market value of \$100,000 and an adjusted basis (in the hands of the distributing corporation immediately before the distribution) of \$40,000. The amount of the distribution of such property as determined under section 301(b)(1)(C) is \$64,000, computed as follows:

(1) Amount computed under section 301(b)(1)(C)(i): That proportion of the adjusted basis of such property (since it is less than the fair market value) which is properly attributable to gross income from sources within the United States, that is, adjusted basis multiplied by the ratio which gross income from sources within the United States bears to gross income from all sources. $\$40,000 \times 60$ percent.....	\$24, 000
(2) Amount computed under section 301(b)(1)(C)(ii): That proportion of the fair market value of such property which is properly attributable to gross income from sources without the United States, that is, fair market value multiplied by the ratio which gross income from sources without the United States bears to gross income from all sources. $\$100,000 \times 40$ percent.....	40, 000
(3) Amount of distribution of property for purposes of section 301.....	64, 000

(b) *Basis*.—Subsection (b) of section 5 of the bill amends section 301(d) of the code (relating to basis of property) by adding a new paragraph (3). The new paragraph (3) provides that where the amount of a distribution of property other than money is determined in accordance with the provisions of subparagraph (C) of section 301(b)(1), the basis of such property shall be the amount of the property distribution. Thus, in the above example the property distributed would have a basis in the hands of corporation X, the distributee, of \$64,000, the amount of the distribution.

(c) *Dividends received from certain foreign corporations*.—Paragraph (1) of subsection (c) of section 5 of the bill amends section 245 of the 1954 Code (relating to dividends received from certain foreign corporations) by adding a new subsection (b). The new subsection (b) provides that for purposes of computing the dividends received deduction under section 245(a) the amount of any distribution of property other than money shall be determined under section 301(b)(1)(B). Under section 301(b)(1)(B) the amount of a distribution of property to a corporate shareholder is the lesser of (1) the fair market value of such property, or (2) the adjusted basis of such property (in the hands of the distributing corporation immediately before the distribution). Thus, for purposes of section 245, the amount of the dividend in the above example would be \$40,000, rather than \$64,000, and the amount allowed as a deduction under section 245 would be \$20,400 ($\$40,000 \times 60\% \times 85\%$).

Paragraph (2) of subsection (c) of section 5 of the bill amends section 245 of the 1954 Code so as to designate the existing text as subsection (a) of section 245.

(d) *Credit for foreign taxes*.—Subsection (d) of section 5 of the bill amends section 902(a) of the 1954 Code (relating to credit for foreign taxes) to provide that for purposes of section 902 (a) and (b) the amount of any distribution in property other than money shall be

determined under section 301(b)(1)(B). Under section 301(b)(1)(B) the amount of a distribution of property to a corporate shareholder is the lesser of (1) the fair market value of such property, or (2) the adjusted basis of such property (in the hands of the distributing corporation immediately before the distribution). Thus, for purposes of section 902(a) the amount of the dividend in the above example would be \$40,000, rather than \$64,000.

(e) *Effective date.*—Subsection (e) of section 5 of the bill provides that the amendments made by section 5 of the bill shall apply to distributions made after December 31, 1962.

SECTION 6. AMENDMENT OF SECTION 482

(a) *In general.*—Subsection (a) of section 6 of the bill amends section 482 of the 1954 Code (relating to allocation of income and deductions among taxpayers) by adding a new subsection (b) relating to sales and purchases within a related group which includes a foreign organization.

Sales and purchases within a related group which includes a foreign corporation—in general

Paragraph (1) of the new section 482(b) provides authority for the Secretary of the Treasury or his delegate to allocate taxable income, arising from sales or purchases of tangible property within a group, which is owned or controlled directly or indirectly, by the same interests and which includes one or more foreign organizations, as well as one or more domestic organizations. New section 482(b) does not apply where an arm's length price can be established for the sales of tangible property. However, it is incumbent upon the taxpayer to establish that the sales price was an arm's length price.

An example of the type of sale which could be dealt with under section 482(b) is as follows: A domestic parent sells articles to a foreign subsidiary where there are not sufficient sales of similar goods to establish an arm's length price. The foreign subsidiary sells the articles to another subsidiary which, in turn sells them to an unrelated organization. In such a situation the Secretary of the Treasury or his delegate could, under section 482(b), allocate, among the members of the group, the total taxable income of the entire group arising out of these sales transactions down to and including the ultimate sale to an unrelated buyer.

Methods of allocation

Paragraph (2)(A) of section 482(b) indicates the factors which the Secretary of the Treasury or his delegate is to take into consideration in making any allocation under such paragraph (2)(A). These factors are specifically enumerated in clauses (i)—(iii).

Clause (i) refers to assets of the group (which are further specified in par. (3)) to the extent used in the production, distribution, and sale of the articles. Clause (ii) refers to compensation of officers and employees, to the extent attributable to the production, distribution, and sale of the articles. Compensation includes salaries and wages and such other elements of compensation as may be definitely associated with the salary and wages so attributable. Clause (iii) refers to advertising, selling, and sales promotion expenses (including technical and servicing expenses), to the extent attributable to the articles.

Paragraph (2)(A) contemplates first determining that portion of any asset or item of expense which is attributable to the articles sold. In applying the enumerated factors to this portion, the following rules will generally apply—

(1) assets will be taken into account on the basis of situs (within or without the United States) and without regard to which organization owns or leases such assets;

(2) salaries and other compensation will be taken into account on the basis of the area (within or without the United States) in which the services attributable to these articles are performed; and

(3) advertising, selling, and sales promotion expenses will be taken into account on the basis of the location (within or without the United States) of the purchasers and potential purchasers with respect to which such expenses are paid or incurred.

The Secretary of the Treasury or his delegate may take into account other factors, including an allowance for special risks of the market in which the articles are sold.

Section 482(b)(2)(B) provides for the use of an alternative method of allocation if the Secretary of the Treasury or his delegate is satisfied that the taxpayer has established that such other method clearly reflects the income of each member.

Special rules

Paragraph (3) of subsection (b) provides that in considering the factor of assets, the values to be assigned to those assets are their adjusted basis in the hands of the taxpayer. If the adjusted basis of an asset is not determinable in the case of a foreign organization, then book value, adjusted to approximate adjusted basis, will be used.

The assets which are to be considered are real property and tangible personal property (whether owned or leased by a member of the group). Inventory and stock in trade are to be excluded from such consideration.

Arm's length price defined

Section 482(b)(4) provides two methods by which the group may establish the existence of an arm's length price. If an arm's length price is established, the new subsection 482(b) does not apply. However, if the arm's length price so established is not the price at which the sales took place, there may be an allocation of income, deductions, etc., under section 482(a). Under subparagraph (A) of section 482(b)(4), the taxpayer may establish an arm's length price as the identifiable price at which tangible personal property, which is similar or comparable to the property sold by such taxpayer, can be sold, or is actually sold, in the same market areas in transactions involving unrelated persons and under similar conditions of sale. For this purpose, the same market area refers to a geographic area, without regard to political boundaries, in which the same market conditions prevail and where it could be expected that prices would be the same. The requirement as to similar conditions of sales means that there should not be excluded from the one sale, and included in the other any circumstance, such as a longer warranty, which would normally have an appreciable influence on the price if included or excluded.

Subparagraph (B) of section 482(b)(4) provides that if it is not possible to establish a price in this manner, then an arm's length price

may still be established if it is possible to adjust the prices at which tangible property similar or comparable to the property referred to above is sold in the same or other areas under similar circumstances and in transactions involving unrelated persons. The adjustments should include those for material differences in quantity, marketing conditions (including customs duty and transportation costs), and other relevant factors. The utilization of this method is limited to situations in which the required adjustments can be properly determined.

An example of the establishment of an arm's length price under subparagraph (B) is the following: Taxpayer A sells product M in country X to a controlled subsidiary, and in country Y A sells a comparable product N to unrelated parties. It is established that the differences between products N and M are of a type which would not ordinarily involve a price differential; the quantity of product M sold to the subsidiary would ordinarily involve a 2% discount over the quantity of product N sold to unrelated parties in country Y; such sales in Y include a warranty not afforded in X, but worth 5% of the sales price; and countries X and Y are areas involving similar market conditions. If all the preceding assumptions are properly determinable by external facts (such as arm's length transactions), the appropriate arm's length price for these sales to the subsidiary in X can be established by reference to these sales in Y.

Sales commissions

Paragraph (5) of the new section 482(b) gives the Secretary of the Treasury or his delegate the authority to allocate commissions arising from sales or purchases of tangible property within the group in the same manner as sales income. The application of section 482(b) to such commission income is to be accomplished under rules contained in regulations prescribed by the Secretary of the Treasury or his delegate, which rules shall be consistent with principles applying under such section to income from sales of tangible property.

Grossly inadequate assets, etc., outside the United States

Paragraph (6) of the new section 482(b) provides that no taxable income is to be allocated to a foreign organization whose assets, personnel, office and other facilities located outside the United States are grossly inadequate for its activities outside the United States. Under such circumstances the total taxable income of the group would be allocated to members other than such organization.

Information necessary for consideration of factors

Paragraph (7) of the new section 482(b) provides that where the allocation referred to in paragraph (2)(A) is involved and where the information submitted with respect to the group is insufficient for such allocation, then if, after a request is made to the group for additional information which may reasonably be supplied, the group fails to supply such additional information, the Secretary of the Treasury or his delegate may estimate the taxable income arising from the particular transaction and allocate such estimated income within the group or to any single member thereof.

Treatment of foreign taxes

Paragraph (8)(A) provides that in making the allocation under section 482(b), taxable income is to be computed without any deduction for any income, war profits, or excess profits taxes paid to any foreign country or United States possession.

Subparagraph (B) of paragraph (8) provides that if the application of section 482(b) results in reducing the taxable income of any foreign organization within the group and in increasing the taxable income of a domestic member of such group, then that portion of the taxes referred to in subparagraph (A) paid by the foreign organization, which is attributable to the income transferred pursuant to such allocation to the domestic member, will be considered as paid by the domestic organization (and as not paid by the foreign organization). Whether such taxes are deducted or credited by the domestic organization would depend on the overall circumstances of that organization.

(b) *Clerical amendment.*—Subsection (b) of section 6 of the bill is a clerical amendment the effect of which is to designate the text of existing section 482 as subsection (a) of section 482.

(c) *Effective date.*—Subsection (c) of section 6 of the bill provides that the amendments made by section 6 of the bill are to apply with respect to taxable years beginning after December 31, 1962.

SECTION 7. DISTRIBUTION OF FOREIGN PERSONAL HOLDING COMPANY INCOME

(a) *Definition of foreign personal holding company.*—Section 552(a) of the 1954 Code now defines the term “foreign personal holding company” to mean any foreign corporation if—

(1) at any time during the taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by or for not more than 5 individuals who are citizens or residents of the United States (referred to as a “United States group”); and

(2) at least 60 percent of its gross income for the taxable year is foreign personal holding company income.

However, if the corporation is a foreign personal holding company with respect to any taxable year, then, for each subsequent taxable year, the minimum percentage is 50 percent in lieu of 60 percent until a taxable year during the whole of which the stock ownership referred to in paragraph (1) does not exist or until the expiration of 3 consecutive taxable years in each of which less than 50 percent of the gross income is foreign personal holding company income.

Subsection (a) of section 7 of the bill amends section 552(a) of the 1954 Code so as to substitute for the gross income requirements referred to above a new rule that a foreign corporation satisfies the gross income requirement if at least 20 percent of its gross income for the taxable year is foreign personal holding company income.

(b) *Amount of undistributed income.*—Section 556(a) of the 1954 Code now defines the term “undistributed foreign personal holding company income” to mean the taxable income of the foreign personal holding company with certain modifications (including a deduction for Federal income taxes and for dividends paid).

Subsection (b) of section 7 of the bill amends section 556(a) so as to retain, in effect, the existing definition where the foreign personal holding income of the foreign personal holding company exceeds 80

percent of its gross income, and to provide that where the foreign personal holding company income does not exceed 80 percent of its gross income, the "undistributed foreign personal holding company income" is to be an amount which bears the same ratio to—

(1) the amount of taxable income (computed and adjusted as under existing law), as

(2) its foreign personal holding company income bears to its gross income.

The amendments made by section 7 of the bill may be illustrated by the following example:

Assume that C, a United States citizen, wholly owns F, a foreign corporation. F has not been a foreign personal holding company for any prior taxable year. For the taxable year F has gross income of \$100 (which includes \$50 of foreign personal holding company income), has deductions under section 556(b) of \$10 (and no other adjustments under section 556(b)), and pays a dividend of \$5. F's taxable income (adjusted as provided in section 556(b)) is \$90. Under existing law, F is not a foreign personal holding company. Under the bill, F is a foreign personal holding company and has undistributed foreign personal holding company income of

$$\$42.50 \left(\frac{50}{100} \times (\$90 - \$5) = 42.50 \right).$$

(c) *Effective date.*—Subsection (c) of section 7 of the bill provides that the amendments made by section 7 are to apply only in respect of taxable years of foreign corporations beginning after December 31, 1962.

SECTION 8. MUTUAL SAVINGS BANKS, ETC.

(a) *In general.*—Subsection (a) of section 8 of the bill amends section 593 of the 1954 Code to provide a new method for calculating the deduction for additions to bad debt reserves allowable to the mutual savings banks, domestic building and loan associations, and cooperative banks, referred to in section 593(a) (all of which are hereinafter referred to as mutual savings institutions).

SECTION 593. RESERVES FOR LOSSES ON LOANS

(a) *Organizations to which section applies.*—Subsection (a) of section 593, as amended by the bill, provides that section 593 is to apply to any mutual savings bank not having capital stock represented by shares, domestic building and loan association, or cooperative bank without capital stock organized and operated for mutual purposes and without profit. This description of the organizations to which section 593 of existing law, and no substantive change is made by this change in description. (As is noted below, however, subsec. (c) of sec. 8 of the bill redefines the term "domestic building and loan association".)

(b) *Additions to reserves for bad debts.*—Subsection (b)(1) prescribes the method for determining the reasonable addition for the taxable year to the reserve for bad debts under section 166(c), and also specifies the reserves to which such additions shall be made. Such reasonable

addition is the sum of two amounts—(1) the amount added to the reserve for losses on nonqualifying loans, and (2) the amount added to the reserve for losses on qualifying real property loans.

The first amount is that determined under section 166(c) to be a reasonable addition to the reserve for losses on nonqualifying loans. Nonqualifying loans are defined in subsection (e)(2), and (with certain exceptions) are loans other than loans secured by an interest in improved real property.

The second amount is the amount determined by the taxpayer to be a reasonable addition to the reserve for losses on qualifying real property loans. However, this amount cannot exceed the amount determined under one of three different methods described in paragraphs (2), (3) and (4) of subsection (b), whichever method produces the largest amount. Qualifying real property loans are defined in subsection (e)(1) and (with certain exceptions) are loans secured by an interest in improved real property.

60 percent of taxable income method

Under this method, which is described in subsection (b)(2), the amount of the reasonable addition to the reserve for losses on qualifying real property loans for a taxable year is limited to the excess of an amount equal to 60 percent of the taxable income for such year over the amount determined under section 166(c) to be a reasonable addition to the reserve for losses on nonqualifying loans. For purposes of this method, taxable income is determined without regard to any deduction under section 166(c) for any additions to the reserves for bad debts, and also by excluding from gross income any amount included therein by reason of subsection (f) (relating to the treatment of certain distributions of property to stockholders by a domestic building and loan association).

3 percent of real property loans method

Under this method, described in subsection (b)(3), the amount of the reasonable addition to the reserve for losses on qualifying real property loans is limited to the amount necessary to increase the balance of such reserve (as of the close of the taxable year) to 3 percent of such loans outstanding at that time.

Experience method

Under this method, described in subsection (b)(4), the amount of the reasonable addition to the reserve for qualifying real property loans is limited to the amount determined under section 166(c) without regard to sec. 593(b) to be a reasonable addition to such reserve.

(c) *Treatment of reserves for bad debts.*—Subsection (c)(1) of section 593 as amended provides that each mutual savings institution which uses the reserve method of accounting for bad debts is to establish and maintain a reserve for losses on qualifying real property loans, a reserve for losses on nonqualifying loans, and a supplemental reserve for losses on loans. Such reserves are to be treated for all purposes as reserves for bad debts. Thus, although these reserves are termed reserves for “losses”, they are to be treated as reserves for bad debts; and any charge to any such reserve for an item other than a bad debt will result in the inclusion in gross income of an amount equal to such charge.

Allocation of pre-1963 reserves

Paragraphs (2) and (3) of subsection (c) prescribe rules governing the method of allocating pre-1963 reserves among the three reserves described above. The term "pre-1963 reserves" is defined by paragraph (4) to mean the net amount, determined as of the close of December 31, 1962 (after applying the provisions of subsec. (d)(1) relating to taxable years beginning in 1962 and ending in 1963), accumulated in the reserve for bad debts pursuant to section 166(c) (or the corresponding provisions of prior revenue laws) for taxable years beginning after December 31, 1951. Thus, reserves accumulated by a mutual savings institution in taxable years beginning prior to December 31, 1951, when the institution was a tax-exempt organization, are not included in pre-1963 reserves and are not to be taken into account for purposes of computing the deduction allowable for additions to reserves for bad debts pursuant to section 593 for periods after December 31, 1962.

Paragraph (2) of subsection (c) provides that such pre-1963 reserves shall, as of the close of December 31, 1962, be allocated to, and constitute the opening balances of, the reserve for losses on nonqualifying loans, the reserve for losses on qualifying real property loans, and the supplemental reserve for losses on loans.

Paragraph (3) of subsection (c) provides that the pre-1963 reserves shall be allocated first to the reserve for losses on nonqualifying loans to the extent that such reserve is not increased above the amount which would constitute a reasonable addition under section 166(c) for a period in which such nonqualifying loans increased from zero to the amount thereof outstanding at the close of December 31, 1962. Thus, the pre-1963 reserves will be allocated to the reserve for losses on nonqualifying loans in an amount not in excess of the maximum amount (determined without regard to any annual limitation which might be imposed under sec. 166(c) on building such reserve to its full amount) which could have been added, as of the close of 1962, to such reserve under subsection (b)(1)(A) if the balance of such reserve immediately prior to such addition had been zero. The remaining portion of the pre-1963 reserves is then allocated to the reserve for losses on qualifying real property loans to the extent such reserve is not increased above the larger of two amounts. The first amount is the amount which would be determined under paragraph (3) of subsection (b) as being necessary to increase the balance of the reserve from zero to 3 percent of qualifying real property loans outstanding at the close of December 31, 1962. The second amount is the amount which would be determined under section 166(c) (without regard to sec. 593) to be a reasonable addition to the reserve for losses on qualifying real property loans for a period in which such loans increased from zero to the amount thereof outstanding at the close of December 31, 1962. Any remaining balance of the pre-1963 reserves is allocated to the supplemental reserve for losses on loans.

Subsection (c)(5) provides that any debt becoming worthless or partially worthless in respect of a qualifying real property loan shall be charged to the reserve for losses on such loans, and any debt becoming worthless or partially worthless in respect of a nonqualifying loan shall be charged to the reserve for losses on nonqualifying loans; except that any such debt may, at the election of the taxpayer, be

charged in whole or in part to the supplemental reserve for losses on loans.

(d) *Taxable years beginning in 1962 and ending in 1963.*—Subsection (d) of the amended section 593 contains provisions for the computation of taxable income in the case of a taxable year which is a fiscal year beginning in 1962 and ending in 1963. With certain exceptions, the general effective date provision in section 8(f)(1) of the bill makes the amended section 593 applicable with respect to taxable years ending after December 31, 1962. However, subsection (d) makes section 593 take effect with respect to fiscal year taxpayers as of January 1, 1963. Subsection (d) apportions taxable income for the entire taxable year (determined without regard to any deduction under sec. 166(c)) between the part of the taxable year which falls in 1962 and the part which falls in 1963. Such taxable income is allocated to each part year on the basis of the ratio which the number of days in each such part year bears to the number of days in the entire taxable year. The portion of such taxable income allocable to the part of the year occurring before January 1, 1963, is then reduced under subsection (d)(1) by an amount equal to the deduction which would have been allowable under section 166(c) for an addition to the reserve for bad debts as if such part year constituted a taxable year and as if section 593, as in effect before the amendments made by section 8 of the bill, applied. The portion of such taxable income allocable to the part of the taxable year occurring after December 31, 1962, is reduced, under subsection (d)(2), by an amount equal to the deduction for an addition to a reserve for bad debts which would be allowed under section 166(c) (taking into account the amendments made by sec. 8 of the bill) if such part year constituted a taxable year. The amounts of taxable income thus obtained for each part year are then added to obtain the taxable income for the entire taxable year.

The amount of the deduction allowable for the pre-1963 part year to a mutual savings institution under subsection (d)(1) is limited, by reason of section 593(2) of existing law, to the amount by which 12 percent of the total deposits or withdrawable accounts of its depositors at the close of such part year (Dec. 31, 1962) exceeds the sum of its surplus, undivided profits, and reserves at the beginning of the taxable year. In addition, by reason of section 593(1) of existing law, the deduction allowable under subsection (d)(1) for the pre-1963 part year to a mutual savings institution cannot exceed the amount of its taxable income (determined without regard to any deduction under sec. 166) allocable to the pre-1963 part year. Although the amount of the deduction allowable for the pre-1963 part year under subsection (d)(1) cannot be determined until the close of the entire taxable year (by reason of the taxable income limitation and because the amount must be reflected on the institution's regular books of account), this amount is added to the institution's pre-1963 reserves. The pre-1963 reserves are then allocated under the rules of subsection (c), as of the close of December 31, 1962, by reference to the amount of nonqualifying loans and qualifying real property loans outstanding at that time.

The deduction referred to in subsection (d)(2) for the post-1962 part year is determined under subsection (b) and is equal to the sum of the amount of an addition to the reserve for losses on nonqualifying loans plus the amount of an addition to the reserve for qualifying

real property loans. The amount of the addition to the reserve for nonqualifying loans is computed by reference to the amount of such loans outstanding at the close of the taxable year in relation to the balance in the reserve for such loans at that time. The amount of the addition to the reserve for qualifying real property loans, if determined under the 60 percent of taxable income method, would be equal to the excess of an amount equal to 60 percent of the taxable income (determined under subsec. (b)(2)) which is allocable to the post-1962 part year over the amount of the reasonable addition to the reserve for nonqualifying loans. If the addition to the reserve for qualifying real property loans is determined under the 3 percent of real property loans method or the experience method, it would be computed by reference to the amount of such loans outstanding at the close of the taxable year in relation to the balance in the reserve for such loans at that time.

(e) *Loans defined.*—Subsection (e) of section 593 defines, for purposes of section 593, the terms “qualifying real property loans”, “nonqualifying loans”, and “loans”.

The term “loan” is defined to mean debt, as the term “debt” is used in section 166. Since subsection (e) of section 166 is made inapplicable by section 582(a) in the case of a mutual savings institution, the term “loan” includes a debt evidenced by a security as defined in section 165(g)(2)(C). For purposes of subsection (e), a taxpayer will be considered to have made a loan to the extent of his participation in the loan, whether the loan was made by him or by another person.

Under paragraph (1) of subsection (e), a “qualifying real property loan” is defined to mean any loan of the taxpayer which is secured by an interest in improved real property unless such loan is described in subparagraph (A), (B), (C), or (D) of such paragraph. The loans described in these subparagraphs are: (A) any loan evidenced by a security (as defined in sec. 165(g)(2)(C)); (B) any loan, whether or not evidenced by a security as defined in section 165(g)(2)(C), the primary obligor on which is a government or political subdivision or instrumentality thereof, a bank as defined in section 581, or another member of the same affiliated group; (C) any loan to the extent secured by a deposit in or share of the taxpayer; and (D) any loan which, within a 60-day period beginning in one taxable year of the creditor and ending in its next taxable year, is made or acquired and then repaid or disposed of, unless the transactions by which such loan was made or acquired and then repaid or disposed of, are established by the taxpayer to be for bona fide business purposes.

The term “affiliated group” is defined as having the meaning assigned to such term by section 1504(a) of existing law; except that (1) the phrase “more than 50%” shall be substituted for the phrase “at least 80%” each place it appears in section 1504(a), and (2) all corporations shall be treated as includible corporations (without any exclusion under sec. 1504(b)).

Paragraph (2) of subsection (e) defines the term “nonqualifying loan” as any loan of the taxpayer which is not a qualifying real property loan as defined by the bill. Thus, a loan which is, for example, evidenced by a security as defined in section 165(g)(2)(C), is treated as a nonqualifying loan irrespective of the fact that it may be secured by improved real property.

(f) *Distributions to shareholders.*—Subsection (f) of section 593, as amended by the bill, prescribes rules governing certain distributions of property (as defined in sec. 317(a)) by a domestic building and loan association to a shareholder with respect to its stock, if such distribution is not allowable as a deduction under section 591. The term “distribution” is defined in paragraph (3)(C) to include any distribution in redemption of stock or in partial or complete liquidation of the association.

Paragraph (1) of subsection (f) provides that a distribution shall be treated as made, first out of the reserve for losses on qualifying real property loans to the extent that the additions made to such reserve pursuant to section 593, as amended by the bill, exceed the additions thereto which would have been allowed under section 166(c) of the code (without regard to sec. 593). The additions made to such reserve include amounts initially added to the reserve pursuant to the allocation rules of subsection (c). The distribution is then treated as made out of the supplemental reserve for losses on loans, to the extent thereof; then out of the association's earnings and profits accumulated in taxable years beginning after December 31, 1951, to the extent thereof; and finally, out of such other accounts as may be proper.

Paragraph (2) of subsection (f) provides that, if a distribution described in paragraph (1) is treated as having been made out of the reserve for losses on qualifying real property loans or out of the supplemental reserve for losses on loans, the amount charged against such reserve shall be the amount which, when reduced by the amount of Federal income tax attributable to the inclusion of such amount in gross income, is equal to the amount of such distribution. Any amount so charged against such reserve shall be included in the gross income of the distributor association. Since the amount so included in gross income is also included in earnings and profits, the effect of subsection (f) is to treat such amount as having been first transferred from the reserves to earnings and profits and then charged to earnings and profits. Thus this rule will normally insure that there will be earnings and profits sufficient to make distributions which are in reality dividends taxable as such, even though the association has previously deducted, in computing its earnings and profits, the amount of additions to its bad debt reserves. However, apart from the consequences which flow from the fact that earnings and profits will be created by such charges to the reserves, income tax consequences to stockholders are not otherwise affected by subsection (f).

Paragraph (3) of subsection (f) provides special rules. Subparagraph (A) provides that, for purposes of treating a distribution as having been made out of the reserve for losses on qualifying real property loans, additions to such reserve for the taxable year in which the distribution occurs shall be taken into account. Thus, the amount of such reserve will be augmented by the addition to such reserve computed under subsection (b) before the reserve is reduced by reason of treating a distribution as having been made out of the reserve. Subparagraph (B) provides that, for purposes of computing (under sec. 593, as amended by the bill) the amount of a reasonable addition to the reserve for losses on qualifying real property loans for any taxable year, any amount charged during any year to such reserve pursuant to the provisions of paragraph (2) of subsection (f)

shall not be taken into account. Thus, the amount by which such reserve is reduced by reason of distributions to stockholders cannot serve as the basis for subsequent deductible additions to such reserve.

SECTION 8. MUTUAL SAVINGS BANKS, ETC. (Continued)

(b) Foreclosure on property securing loans.—Subsection (b) of section 8 of the bill adds a new section 595 to the code. The section applies only to a creditor which is a mutual savings institution described in the amended section 593(a).

Nonrecognition of gain or loss as a result of foreclosure

Subsection (a) of the new section 595 provides that in the case of a creditor which is an organization described in section 593(a), no gain or loss shall be recognized, and no debt shall be considered as becoming worthless or partially worthless, as the result of such organization having bid in at foreclosure, or having otherwise reduced to ownership or possession by agreement or process of law, any property which was security for the payment of any indebtedness.

Character of property

Subsection (b) of the new section 595 provides that, for purposes of sections 166 (relating to the deduction for bad debts) and 1221 (relating to the definition of a capital asset), any property acquired in a transaction with respect to which gain or loss was not recognized to the creditor by reason of subsection (a) shall be considered as property having the same characteristics as the indebtedness for which such property was security. The subsection further provides that any amount realized by such creditor with respect to such property shall be treated (for purposes of ch. 1 of the code) as a payment on account of such indebtedness, and that any loss with respect to such property shall be treated as a bad debt to which the provisions of section 166 apply.

Basis

Subsection (c) of the new section 595 provides that the basis of any property acquired in a transaction to which subsection (a) applies shall be the basis of the indebtedness for which such property was security, determined as of the date of the acquisition of such property, properly increased for any costs of acquisition.

Regulatory authority

Subsection (d) of the new section 595 provides that the Secretary of the Treasury or his delegate shall prescribe such regulations as he may deem necessary to carry out the purposes of this section.

(c) Definition of domestic building and loan association.—Subsection (c) of section 8 of the bill amends paragraph (19) of section 7701(a) of the code to provide a new definition of the term “domestic building and loan association”. As amended, paragraph (19) of section 7701(a) defines such term to mean any domestic building and loan association, domestic savings and loan association, or Federal savings and loan association, which is either (i) an insured institution within the meaning of section 401(a) of the National Housing Act (12 U.S.C., § 1724(a)), or (ii) is subject by law to supervision and examination by State or Federal authority having supervision over such associations, but only if substantially all of its business meets specified requirements.

The "insured institutions" referred to are those the accounts of which are insured by the Federal Savings and Loan Insurance Corporation. The new definition requires that substantially all the business of an association consist of accepting savings and investing the proceeds (i) in loans secured by real property which is (or, from the proceeds of the loan, will become) residential real property, and (ii) in other loans, to the extent such other loans would be authorized to be made by a Federal savings and loan association under the second paragraph of section 5(c) of the Home Owners' Loan Act, as amended (12 U.S.C., § 1464(c)). These provisions authorize a Federal savings and loan association to invest a sum not in excess of 15 percent of its assets in specified loans, including unsecured loans, for property alteration, repair, or improvement.

(d) *Clerical amendments.*—Subsection (d) of section 8 of the bill contains clerical amendments.

(e) *Repeal of exemption from communications and transportation of persons taxes.*—Under section 5(h) of the Home Owners' Loan Act of 1933 (48 Stat. 132; 12 U.S.C., § 1464(h)), Federal savings and loan associations are exempted from the excise tax on communications and the excise tax on the transportation of persons now imposed by sections 4251 and 4261 of the code. Subsection (e) of section 8 of the bill provides that, notwithstanding any other provision of law, a Federal savings and loan association shall not be exempt as such from the excise taxes imposed by sections 4251 and 4261 of the code.

(f) *Effective dates.*—Subsection (f) of section 8 of the bill provides effective dates for subsections (a), (b) and (e) of section 8 of the bill.

Paragraph (1) of section 8(f) of the bill provides that the amendments made by section 8(a) of the bill (which amends sec. 593 of existing law) shall apply to taxable years ending after December 31, 1962, except that section 593(f) of the code shall apply to distributions after December 31, 1962, in taxable years ending after such date.

Paragraph (2) of section 8(f) of the bill provides that the amendments made by section 8(b) of the bill (which adds a new sec. 595) shall apply to transactions described in section 595(a) of the code occurring after December 31, 1962, in taxable years ending after such date.

Paragraph (3) of section 8(f) of the bill provides that subsection (e) shall apply, in the case of the tax imposed by section 4251 of the code, with respect to amounts paid pursuant to bills rendered after June 30, 1962; and, in the case of the tax imposed by section 4261 of the code, with respect to transportation beginning after June 30, 1962.

SECTION 9. DISTRIBUTIONS BY FOREIGN TRUSTS

(a) *Definitions.*—Section 9(a) of the bill amends section 643 of the 1954 Code (definitions relating to the income of estates and trusts) in the following respects.

Modification of distributable net income

Section 9(a)(1) of the bill amends section 643(a)(6) (relating to modifications taken into account in computing distributable net income) in two respects. First, a new subparagraph (B) is added to section 643(a)(6) to provide that the gross income of a foreign

trust from sources within the United States is to be determined without regard to section 894 (relating to income exempt under treaty). A further amendment is made to section 643(a)(6) by the addition of a new subparagraph (C). The new section 643(a)(6)(C) provides that section 643(a)(3) (relating to capital gains and losses) is not to apply to a "foreign trust created by a United States person", as defined in section 643(d). In lieu of the rules provided by section 643(a)(3), the new subparagraph (C) provides that there is to be included in distributable net income gains from the sale or exchange of capital assets, reduced by losses from such sales or exchanges to the extent such losses do not exceed gains from such sales or exchanges. The new subparagraph (C) also provides that the deduction under section 1202 (relating to deduction for excess of capital gains over capital losses) is not to be taken into account. Existing section 643(a)(3) will continue to apply to trusts other than foreign trusts created by United States persons.

Foreign trusts created by United States persons

Section 9(a)(2) of the bill adds a new subsection (d) to section 643 of the 1954 Code. The new section 643(d) provides that, for purposes of part I of subchapter J (relating to estates, trusts, and beneficiaries), the term "foreign trust created by a United States person" means a foreign trust (as defined in sec. 7701(a)(31)) to which money or property has been transferred directly or indirectly by a United States person (as defined in sec. 7701(a)(30)), or under the will of a decedent who at the date of his death was a United States citizen or resident. A foreign trust, created by a person who is not a United States person, to which a United States person transfers money or property would under this definition be a foreign trust created by a United States person.

(b) *Modification of throwback.*—Subsections (b) through (d) of section 9 of the bill make various amendments designed to modify the so-called throwback provisions of the code in their application to certain foreign trusts.

Existing law

Under existing law the so-called throwback provisions of subchapter J operate substantially as follows. When a beneficiary receives as a distribution an amount in excess of current distributable net income, and the distribution exceeds \$2,000, it is called an accumulation distribution. The beneficiary is taxed on this amount to the extent there was undistributed net income of the trust in any of the preceding 5 years, the undistributed net income of such prior years being taken into account in inverse order. Undistributed net income consists of undistributed distributable net income for a taxable year, minus the taxes on the trust attributable to such undistributed amount. The beneficiary is also required to include in gross income an appropriate portion of the United States income taxes, if any, imposed on the trust with respect to the undistributed net income, but he receives a tax credit based on the taxes the trust would not have had to pay if the undistributed distributable net income had actually been paid to the beneficiary.

Although under section 668(a) the beneficiary is taxable currently on the entire distribution, as well as on the taxes on the trust allocable

to that amount, the tax attributable to the distribution cannot exceed the tax he would have paid had the distribution been paid to him on the last day of each of the preceding taxable years to the extent the undistributed net income of each of those years is considered absorbed by the distribution. The taxes deemed distributed to him are similarly spread back.

Under existing law, however, as noted, the throwback rule does not operate with respect to distributions made out of accumulations for taxable years before the fifth year preceding the taxable year. In addition, there are certain exceptions to what may be taken into account in determining whether there has been an accumulation distribution, e.g., a distribution out of accumulations for a minor, or a final distribution of the trust made to a beneficiary more than 9 years after the date of the last transfer to the trust.

Modification of accumulation distribution

Section 9(b)(1) of the bill amends section 665(b) (relating to the definition of accumulation distribution) to limit the application of such definition to trusts other than foreign trusts created by United States persons. A new section 665(c), added by section 9(b)(2) of the bill, provides a definition of accumulation distribution for foreign trusts created by United States persons. Under this new definition, a distribution in excess of current distributable net income constitutes an accumulation distribution whether or not the distribution exceeds \$2,000. In addition, there are no exceptions to what may be taken into account in determining whether there has been an accumulation distribution. Thus, any distribution in excess of current distributable net income will, under the new section 665(c), be an accumulation distribution.

The last sentence of section 665(c) provides that any amount paid to a United States person which is from a payor who is not a United States person, and which is derived directly or indirectly from a foreign trust created by a United States person, is to be deemed in the year of payment to have been directly paid by the foreign trust. Thus, if a nonresident alien receives a distribution from a foreign trust created by a United States person and he then pays the amount of the distribution over to a United States person, the payment of such amount to the United States person represents an accumulation distribution to the United States person from such trust, to the extent that the amount received would have been an accumulation distribution had the trust paid the amount directly to the United States person. An example of a payment indirectly derived by a nonresident alien from such a foreign trust would be where the trust distributes to a foreign trust which was not created by a United States person, and which latter foreign trust makes a distribution to the nonresident alien. In this case, the payment over to a United States person is considered to have been made from the initial and not from the intervening trust. The same result would obtain if the intervening trust were a foreign trust created by a United States person. However, even if a payment is made to a United States person by a person who is not a United States person and who directly or indirectly derived the amount paid from a foreign trust created by a United States person, the receipt of the amount by the United States person is not considered the receipt of an accumulation distribution from a trust if the

amount is received under circumstances indicating lack of intent on the part of the parties to circumvent the amendments made by section 9 of the bill.

Other modifications to the throwback rule

The restriction of the throwback rule to the 5 preceding taxable years of the trust is removed by section 9(c)(2) of the bill for foreign trusts created by a United States person. However, this unlimited throwback will operate only for years governed by the 1954 Code.

Section 9(d) of the bill adds a new sentence to section 668(a) (relating to amounts treated as received in prior taxable years). In the case of a United States person who is a beneficiary of a foreign trust created by a United States person, this sentence conditions the availability of the limitation on tax provided by section 668(a) on a beneficiary's meeting the information requirements of new section 669(b), added by section 9(e) of the bill.

The provisions of subchapter J which remain unchanged by the bill will continue to apply as under existing law. Thus, the credit allowed to a beneficiary by section 668(b) for United States income taxes paid by the trust, and the credit against tax for taxes imposed by foreign countries will continue to be available.

SECTION 9. DISTRIBUTIONS BY FOREIGN TRUSTS (Continued)

(e) *Limitation on tax.*—Section 9(e) of the bill adds a new section 669 to subpart D of part 1 of subchapter J of chapter 1 (relating to treatment of excess distributions by trusts).

SECTION 669. SPECIAL RULES APPLICABLE TO CERTAIN FOREIGN TRUSTS

Section 669 provides that a beneficiary who is a United States person and who satisfies certain additional requirements may elect between two methods of computing the limitation on tax attributable to an accumulation distribution received from a foreign trust created by a United States person. These two methods are in addition to the method available to the beneficiary of computing his tax in the ordinary way by including in income the entire amount of an accumulation distribution when it is paid, credited, or required to be distributed. The additional requirements referred to which must be satisfied by the beneficiary are those provided in section 669(b), relating to the furnishing of certain information by the beneficiary with respect to the operation and accounts of the trust. Information may be required to be furnished for each taxable year of the trust on the last day of which an amount is deemed distributed by the trust under section 666(a). The nature and extent of the information required is to be determined by regulations prescribed by the Secretary of the Treasury or his delegate.

First method of limiting tax

As noted above, section 669(a) provides for an election by the beneficiary as between two methods of computing the limitation on tax attributable to the receipt of an accumulation distribution. The first method is the one provided by existing law, and which is now

contained in the next to the last sentence of section 668(a). However, section 669(a)(2)(B) provides that this method may not be elected if the beneficiary was not alive on the last day of each preceding taxable year of the trust with respect to which a distribution is deemed made under section 666(a). Thus, if a portion of an amount received as an accumulation distribution was accumulated by the trust during years when the beneficiary was unborn, the beneficiary is not permitted to elect the limitation on tax provided by section 669(a)(1)(A).

Second method of limiting tax

The second method of limiting tax is provided by section 669(a)(1)(B). Under this method the beneficiary's gross income for the taxable year in which the accumulation distribution is paid, credited, or required to be distributed to him (determined without regard to the inclusion in income required by sec. 668(a) of any amount other than pursuant to sec. 669(a)(1)(B)) and for each of his 2 taxable years immediately preceding such year is recomputed solely for purposes of determining the limitation on the beneficiary's tax for the current year. The income for each of such 3 years is recomputed by adding thereto an amount determined by dividing the amount required to be included in income under section 668(a) by the number of preceding taxable years of the trust on the last day of each of which an amount is deemed under section 666(a) to have been distributed. There is then computed the increase in tax for each of such 3 years attributable to the increased amount of gross income. The aggregate of the increases in tax for such 3 years is divided by 3 to arrive at an average increase in tax for such 3 years. This average increase in tax, multiplied by the number of preceding taxable years of the trust from the income of which the distribution is made, is the limitation on the beneficiary's tax liability (before the application of any credit for taxes paid by the trust allowed by sec. 668(b)) with respect to the accumulation distribution.

The computation made under the alternate election provided by section 669(a)(1)(B) is modified in two cases. When an accumulation distribution is deemed under section 666(a) to have been distributed on the last day of less than 3 taxable years of the trust, the taxable years of the beneficiary for which a recomputation is made under section 669(a)(1)(B) is limited to the number of years to which section 666(a) applies, commencing with the most recent taxable year of the beneficiary. Also, no recomputation of gross income is to be made for a beneficiary for a taxable year for which he was not alive on the last day thereof; and if the beneficiary has no preceding taxable year, the recomputation of gross income is made on the basis of his taxable year without regard to the inclusion in income required by section 668(a) of any amount other than pursuant to section 669(a)(1)(B).

The application of the preceding paragraph may be illustrated by the following examples: Assume that a foreign trust created by a United States person accumulates \$3,000 of income for one year and \$7,000 for a second year and then distributes the accumulated income on January 1, 1965, to a beneficiary who is a United States person. The limitation on tax computed under section 669(a)(1)(B) would be determined by recomputing the beneficiary's gross income for

1964 and 1965 by adding \$5,000 to each year. If the same distribution were made to an infant who was born in 1965, the limitation on tax would be computed by adding \$5,000 to his gross income for such year. The resulting increase in tax would be multiplied by two to arrive at the limitation on the increase in his tax for 1965 attributable to such distribution.

Effect of prior election

Section 669(a)(3) provides special rules which have application when a beneficiary who is a United States person receives a second or succeeding accumulation distribution from a foreign trust created by a United States person.

If a beneficiary has elected the limitation on tax provided by section 669(a)(1)(B) (the second method described herein) with respect to an accumulation distribution, and with respect to a subsequent accumulation distribution he desires to elect the limitation on tax provided by section 669(a)(1)(A) (the method provided by existing law), for purposes of computing the limitation on tax with respect to the subsequent accumulation distribution the income of any year with respect to which an amount is deemed distributed to a beneficiary under section 666(a) is to include amounts previously deemed distributed to such beneficiary for such year as a result of an accumulation distribution with respect to which an election under section 669(a)(1)(B) was made. The result of this rule is to require that for the purposes of computing the limitation on tax under section 669(a)(1)(A) with respect to an accumulation distribution, all previous elections are considered to have been made under section 669(a)(1)(A). However, this rule does not deny to the beneficiary the benefit previously derived by him as a result of an election under section 669(a)(1)(B) with respect to an earlier accumulation distribution.

A special rule is also provided by section 669(a)(3) regardless of the limitation on tax elected with respect to a prior accumulation distribution when, with respect to a subsequent accumulation distribution, the limitation on tax provided by section 669(a)(1)(B) is elected by the beneficiary. When this occurs the number of preceding taxable years of the trust with respect to which an amount is deemed distributed to a beneficiary under section 666(a) is to be determined without regard to any such year with respect to which an amount was previously deemed distributed to such beneficiary.

SECTION 9. DISTRIBUTIONS BY FOREIGN TRUSTS (Continued)

(f) *Requirement of information return.*—Section 9(f) of the bill amends subpart B of part III of subchapter A of chapter 61 (relating to information concerning transactions with other persons) by adding a new section 6047.

SECTION 6047. RETURNS AS TO CREATION OF OR TRANSFERS TO CERTAIN FOREIGN TRUSTS

Section 6047 provides for the filing of an information return on or before the 90th day after the creation of any foreign trust by a United States person or after the transfer of any money or property to a

foreign trust by a United States person. The return is to be in such form and is to set forth, in respect of the foreign trust, such information as the Secretary of the Treasury or his delegate prescribes by regulation as necessary for carrying out the provisions of the income tax laws. The return is required to be filed by the grantor in the case of an inter vivos trust, the fiduciary of an estate in the case of a testamentary trust, or by the transferor to a foreign trust, as the case may be.

(g) *Penalty for failure to file return.*—Section 9(g) of the bill amends subchapter B of chapter 68 (relating to assessable penalties) by adding a new section 6677.

SECTION 6677. FAILURE TO FILE INFORMATION RETURNS WITH RESPECT
TO CERTAIN FOREIGN TRUSTS

Section 6677(a) provides that, in addition to any criminal penalty provided by law (such as the penalty provided by sec. 7203 for willful failure to file a return), any person required to file a return under section 6047 who fails to file such return at the time provided in such section, or who files a return which does not show the information required pursuant to such section, is to pay a penalty equal to 5 percent of the amount transferred to a trust, but not more than \$1,000, unless it is shown that such failure is due to reasonable cause.

Section 6677(b) provides that the assessment or collection of any penalty imposed by section 6677(a) is not to be subject to the deficiency procedures provided by subchapter B of chapter 63 of the code.

(h) *Definitions.*—Section 9(h) of the bill amends section 7701(a) (relating to definitions) by adding paragraphs (30) and (31). Paragraph (30) defines the term “United States person” to mean a citizen or resident of the United States; a domestic partnership; a domestic corporation; and any estate or trust (other than a foreign estate or foreign trust, within the meaning of sec. 7701(a)(31)). Paragraph (31) defines the terms “foreign estate” and “foreign trust” to mean an estate or trust, as the case may be, the income of which from sources without the United States is not includible in gross income under subtitle A of the code (relating to income taxes).

(i) *Technical amendments.*—Section 9(i) of the bill amends the tables of sections where necessary to reflect the addition of the new sections added by the bill.

(j) *Effective date.*—The amendments made by section 9 of the bill (other than by subsecs. (f), (g), and (h)) are to apply with respect to distributions made in taxable years of trusts beginning after the date of the enactment of the bill. The amendments made by subsections (f), (g), and (h) will take effect on such date of enactment.

SECTION 10. MUTUAL INSURANCE COMPANIES (OTHER
THAN LIFE, MARINE, AND CERTAIN FIRE INSURANCE
COMPANIES), ETC.

(a) *Imposition of tax.*—Subsection (a) of section 10 of the bill amends the heading and table of sections for part II of subchapter L of chapter 1 of the 1954 Code to conform them to the substantive changes made by the bill. In addition, subsection (a) in effect strikes

out existing section 821 of the code and substitutes a new section 821, relating to the tax on mutual insurance companies to which part II applies.

SECTION 821. TAX ON MUTUAL INSURANCE COMPANIES TO WHICH PART II
APPLIES

(a) *Imposition of tax.*—Subsection (a) of the new section 821 provides the general rule for taxing mutual insurance companies (including interinsurers and reciprocal underwriters). The tax will not apply to a mutual life insurance company or to a mutual marine or mutual fire insurance company subject to the tax imposed by section 831 of the 1954 Code. In addition, the tax will not apply if the alternative tax imposed by the new section 821(c) (relating to alternative tax for certain small companies) applies. Also, mutual insurance companies (other than life or marine) whose gross receipts (not including capital gains) for the taxable year do not exceed \$75,000 will continue to be exempt from tax under section 501(c)(15) of the 1954 Code.

The tax imposed by the new section 821(a) applies to each taxable year beginning after December 31, 1962. The tax is to consist of—

(1) a normal tax of 25 percent of the mutual insurance company taxable income, or 50 percent of the amount by which such taxable income exceeds \$6,000, whichever is the lesser; and

(2) a surtax of 22 percent of the mutual insurance company taxable income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) in excess of \$25,000.

Under existing law a mutual insurance company which is subject to the tax on investment income only is exempt from tax if its mutual insurance company taxable income does not exceed \$3,000. Similarly, existing law provides special notch relief if such a company has mutual insurance company taxable income between \$3,000 and \$6,000. Under the bill, companies having mutual insurance company taxable income (as defined in the new sec. 821(b)) which does not exceed \$6,000 will be exempt from tax, and the special notch provision will apply if the company has mutual insurance company taxable income between \$6,000 and \$12,000.

(b) *Mutual insurance company taxable income defined.*—Subsection (b) of the new section 821 defines the term “mutual insurance company taxable income” for purposes of part II of subchapter L. Under this definition, mutual insurance company taxable income means the amount by which—

(1) the sum of—

(A) the taxable investment income (as defined in sec. 822(a)(1)),

(B) the statutory underwriting income (as defined in sec. 823(a)(1)), and

(C) the amounts required by section 824(d) to be subtracted from the protection against loss account, exceeds

(2) the sum of—

(A) the investment loss (as defined in sec. 822(a)(2)), if any,

(B) the statutory underwriting loss (as defined in sec. 823(a)(2)), if any, and

(C) the unused loss deduction provided by section 825(a).

If for any taxable year the amount determined under paragraph (2) of the new section 821(b) exceeds the amount determined under paragraph (1) of the new section 821(b), the mutual insurance company taxable income shall be zero.

(c) *Alternative tax for certain small companies.*—Paragraph (1) of the new section 821(c) provides an alternative tax which is in lieu of the tax imposed by section 821(a) for taxable years beginning after December 31, 1962. Except as provided in section 821(c)(3)(B), this tax applies in the case of every mutual insurance company described in section 821(c)(3)(A) and consists of—

(1) a normal tax of 25 percent of the taxable investment income (as defined in sec. 822(a)(1)), or 50 percent of the amount by which such taxable income exceeds \$3,000, whichever is the lesser; and

(2) a surtax of 22 percent of the taxable investment income (computed without regard to the deduction provided in sec. 242 for partially tax-exempt interest) in excess of \$25,000.

Thus, paragraph (1) of the new section 821(c) provides, in effect that certain small mutual insurance companies shall be taxed at regular corporate rates on taxable investment income only. Under the bill, such companies will continue to be taxed the same as under present law, except that the alternative 1-percent tax will not apply. Accordingly, if such a company has taxable investment income of less than \$3,000, it is not subject to tax, and if the taxable investment income is between \$3,000 and \$6,000, it is entitled to special notch relief. Unless such a company makes an election to be taxed under section 821(a), its underwriting gains or losses will not be taken into account for purposes of determining its tax liability.

Paragraph (2) of the new section 821(c) is identical to section 821(c) of existing law which provides a special tax reduction for companies subject to tax under section 821. Under present law, if the gross amount received during the taxable year from the items described in section 822(b) (other than par. (1)(D) thereof) and premiums (including deposits and assessments) is over \$75,000 but less than \$125,000, the tax otherwise computed under existing section 821(a) (1) or (2) or section 821(b) is reduced to an amount which bears the same proportion to such tax as the excess over \$75,000 bears to \$50,000. However, under the bill, this special relief provision is to apply only to companies which are subject to the tax imposed by the new section 821(c) and is not to apply in the case of companies which are subject to the tax imposed by the new section 821(a).

Subparagraph (A) of the new section 821(c)(3) provides that, except as provided by section 821(c)(3)(B), every mutual insurance company (other than a life insurance company and other than a fire or marine insurance company subject to the tax imposed by sec. 831) is to be subject to the tax imposed by section 821(c) if the gross amount received during the taxable year from the items described in section 822(b) (other than par. (1)(D) thereof) and premiums (including deposits and assessments) exceeds \$75,000 but does not exceed \$300,000.

Subparagraph (B) of the new section 821(c)(3) provides that a mutual insurance company described in section 821(c)(3)(A) shall not

be subject to the alternative tax imposed by section 821(c)(1) for the taxable year if there is in effect for the taxable year an election made by such company under section 821(d) to be taxable under section 821(a), or if there is any amount in the protection against loss account of such company at the beginning of the taxable year. Where the alternative tax treatment for certain small companies does not apply by reason of there being an amount in the protection against loss account at the beginning of the taxable year, the bill provides that an election may be made to subtract such amount from the protection against loss account as of the close of the preceding taxable year. See section 824(d)(5).

(d) *Election to include statutory underwriting income or loss.*—Paragraph (1) of the new section 821(d) provides that any mutual insurance company which is subject to the tax imposed by section 821(c) may elect to be subject to the tax imposed by section 821(a). Paragraph (2) provides that if the company makes such an election it shall be subject to the tax imposed by section 821(a) for the first taxable year for which the election is made and for all taxable years thereafter unless the Secretary or his delegate consents to a revocation of such election. Under the bill, it is not intended to permit such companies an annual election to be taxed either under subsection (a) or (c) of the new section 821. However, there may be some situations where because of a substantial change in the character of the taxpayer's operations there would be an undue burden or material hardship if such taxpayer were not permitted to revoke its prior election. Under such circumstances, the bill provides that the election may be revoked with the consent of the Secretary or his delegate. If, however, for any taxable year for which the election would otherwise apply, the gross amount received by the company during the taxable year from the items described in section 822(b) (other than par. (1)(D) thereof) and premiums (including deposits and assessments) does not exceed \$75,000, such election will terminate automatically. Thus, if for any taxable year thereafter such a company has gross receipts from such sources of over \$75,000 but not more than \$300,000, it shall be subject to tax under section 821(c) unless it makes a new election to be taxed under section 821(a).

(e) *No United States insurance business.*—Subsection (e) of the new section 821 is identical with section 821(d) of existing law and provides that foreign mutual insurance companies (other than a life insurance company and other than a fire or marine insurance company subject to the tax imposed by sec. 831) not carrying on an insurance business within the United States are not to be subject to tax under part II of subchapter L but shall be taxable as other foreign corporations. See section 881 of the code.

(f) *Cross references.*—Subsection (f) of the new section 821 contains cross references to section 501(c)(15) of the code (relating to exemption from tax of certain mutual insurance companies) and section 1201(a) (relating to alternative tax in case of capital gains).

SECTION 10. MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE, MARINE, AND CERTAIN FIRE INSURANCE COMPANIES), ETC. (Continued)

(b) *Taxable investment income.*—Subsection (b) of section 10 of the bill contains technical amendments to sections 822 and 823 of the code. These amendments, in effect, retain the existing substantive provisions of section 822 but change the designation of the excess of gross investment income (as defined in sec. 822(b)) over gross investment deductions (as provided in sec. 822(c)) from “mutual insurance company taxable income” to “taxable investment income.”

Subsection (b)(1) of section 10 of the bill changes the heading of section 822 to refer to taxable investment income and amends section 822(a) to define the terms “taxable investment income” and “investment loss” for purposes of part II of subchapter L. The investment loss is the excess of gross investment deductions over gross investment income.

Subsection (b)(2) of section 10 of the bill amends section 822(c) of the code (relating to deductions) and section 822(e) of the code (relating to foreign mutual insurance companies) by striking out the term “mutual insurance company taxable income” each place it appears and inserting in lieu thereof the term “taxable investment income”. This amendment conforms to the amendment to section 822(a).

Subsection (b)(3) of section 10 of the bill amends section 822(c)(7) of the code (relating to special deductions) and provides that for purposes of paragraph (7) of section 822(c), in applying section 246(b) (relating to limitation on aggregate amount of deductions for dividends received), the reference in section 246(b) to “taxable income” is to be treated as a reference to “taxable investment income.”

Subsection (b)(4) of section 10 of the bill redesignates section 823 of the code (relating to other definitions) as subsection (f) of the new section 822.

(c) *Statutory underwriting income or loss.*—Subsection (c) of section 10 of the bill adds (after sec. 822(f), as redesignated by subsec. (b)(4) of sec. 10 of the bill) a new section 823, relating to determination of statutory underwriting income or loss, and a new section 824, relating to adjustments to provide protection against losses.

SECTION 823. DETERMINATION OF STATUTORY UNDERWRITING INCOME OR LOSS

(a) *In general.*—Paragraph (1) of the new section 823(a) defines the term “statutory underwriting income” for purposes of part II of subchapter L. Under this definition, statutory underwriting income is the amount by which—

(1) the gross income which would be taken into account in computing taxable income under section 832 if the taxpayer were subject to the tax imposed by section 831, reduced by the gross investment income (as determined under sec. 822(b)), exceeds

(2) the sum of—

(A) the deductions which would be taken into account in computing taxable income if the taxpayer were subject to

the tax imposed by section 831, reduced by the deductions provided in section 822(c) (relating to deductions in computing taxable investment income), plus

(B) the deductions provided in subsection (c) of the new section 823 (relating to special deduction for small company having gross amount of less than \$900,000) and in section 824(a) (relating to deduction to provide protection against losses).

Paragraph (2) of the new section 823(a) provides that, for purposes of part II of subchapter L, the term "statutory underwriting loss" means the amount by which the amount referred to in paragraph (1)(B) of the new section 823(a) exceeds the amount referred to in paragraph (1)(A) of the new section 823(a).

Paragraphs (1) and (2) of the new section 823(a) provide, in effect, that for purposes of determining statutory underwriting income or loss for the taxable year a mutual insurance company subject to the tax imposed by section 821(a) must first take into account the same gross income and deduction items (except as modified by sec. 823(b)) as a taxpayer subject to tax under section 831 would take into account for purposes of determining its taxable income under section 832. These items are then reduced to the extent that they include amounts which are included in determining taxable investment income under section 822(a). In addition, the taxpayer is allowed a deduction for the amount determined under section 824(a) (relating to deduction to provide protection against losses) and, in the case of a company having gross receipts of less than \$900,000, an additional deduction equal to the amount determined under section 823(c)(1), after the application of the limitation provided in section 823(c)(2).

(b) *Modifications.*—Subsection (b) of the new section 823 provides certain modifications to the general rule for determining statutory underwriting income or loss contained in section 823(a). Paragraph (1) of section 823(b) provides that for purposes of applying section 823(a), the deduction for net operating losses provided by section 172 is not to be allowed. (However, such a company is allowed an unused loss deduction under the provisions of sec. 825.) Paragraph (2) of the new section 823(b) provides a special rule which applies in the case of an interinsurer or reciprocal underwriter which is subject to the tax imposed by section 821(a). This rule provides that if such a company, before the 16th day of the 3d month following the close of the taxable year, credits the individual account of each of its subscribers with an amount, representing savings to subscribers for the taxable year, which it would be obligated to pay promptly to such subscriber if he terminated his contract at the close of the company's taxable year, then—

(1) there is to be allowed as a deduction the increase for the taxable year in savings credited to subscriber accounts, or

(2) there is to be included as an item of gross income the decrease for the taxable year in savings credited to subscriber accounts.

Any amount representing savings credited to his account for the taxable year is to be treated by the subscriber as a dividend paid or declared for purposes of his taxable income. Thus, the amount of any savings credited to a subscriber within the meaning of this section shall be taken into account by him in computing his income to the

extent that the cost of the insurance with respect to which the savings are credited constitutes a business expense.

(c) *Special deduction for small company having gross amount of less than \$900,000.*—Subsection (c) of the new section 823 relates to the special deduction for certain small companies having gross receipts of less than \$900,000. Paragraph (1) of the new section 823(c) provides that if the gross amount received during the taxable year from the items described in section 822(b) (other than par. (1)(D) thereof) and net premiums (including deposits and assessments) is less than \$900,000, then, subject to the limitation provided in paragraph (2) of the new section 823(c) there shall be allowed an additional deduction for purposes of determining statutory underwriting income or loss (under subsec. (a) of the new sec. 823) for the taxable year. This additional deduction is \$6,000; except that if the gross amount exceeds \$300,000, the additional deduction is limited to an amount equal to 1 percent of the amount by which \$900,000 exceeds such gross amount. The special deduction provided by paragraph (1) does not apply if the taxpayer is either subject to the tax imposed by section 821(c) (relating to alternative tax for certain small companies) or has gross amounts of \$900,000 or more.

Paragraph (2) of the new section 823(c) provides that the amount of the deduction allowed under paragraph (1) of the new section 823(c) is not to exceed the statutory underwriting income (as defined in sec. 823(a)(1)) for the taxable year, computed without regard to the deduction under paragraph (1) or the deduction allowed under section 824(a) (relating to deduction for protection against losses).

Example: The application of section 823(c) may be illustrated by the following example:

Company M, a mutual insurance company subject to the tax imposed by section 821(a), has the following items for the taxable year 1963:

Gross amount for purposes of sec. 823(c)(1)	\$400, 000
Gross investment income (including capital gains)	75, 000
Capital gains	50, 000
Gross income under sec. 832	450, 000
Deductions under sec. 822(c)	71, 000
Deductions under sec. 832 (as modified by sec. 823(b))	433, 000

Under the provisions of section 823(c), company M's special small company deduction for the taxable year 1963 would be \$5,000, computed as follows:

(1) Gross amount for purposes of sec. 823(c)(1)	\$400, 000
(2) Amount by which \$900,000 exceeds item (1) (\$900,000 minus \$400,000)	500, 000
(3) 1 percent of item (2), not to exceed \$6, 000	5, 000
(4) Gross income under sec. 832, reduced by gross investment income (\$450,000 minus \$75,000)	\$375, 000
(5) Deductions under sec. 832 (as modified by sec. 823(b), reduced by deductions under sec. 822(c) (\$433,000 minus \$71,000)	362, 000
(6) Limitation on deduction under sec. 823(c)(1) (excess, if any, of item (4) over item (5))	13, 000
(7) Deduction under sec. 823(c)(1) (item (3) or item (6), whichever is the lesser)	5, 000

SECTION 824. ADJUSTMENTS TO PROVIDE PROTECTION AGAINST LOSSES

(a) *Allowance of deduction.*—Paragraph (1) of the new section 824(a) provides that for purposes of determining the statutory underwriting income or loss (as defined in sec. 823(a)) for any taxable year there is to be allowed as a deduction to provide protection against losses the sum of—

(1) 1 percent of the losses incurred during the taxable year (as determined under sec. 832(b)(5)); plus

(2) 25 percent of the underwriting gain for the taxable year; plus

(3) if the concentrated windstorm, etc., premium percentage for the taxable year (as defined in par. (2) of the new sec. 824(a)) exceeds 50 percent, the amount determined by applying so much of the concentrated windstorm, etc., premium percentage as exceeds 50 percent to the underwriting gain for the taxable year.

For purposes of paragraph (1) of the new section 824(a), the term “underwriting gain” means the statutory underwriting income computed under section 823(a) without regard to the deduction provided by paragraph (1) of the new section 824(a).

Subparagraph (C) of the new section 824(a)(1) permits an additional deduction for protection against losses in the case of certain companies having concentrated windstorm, etc., risks. For example, assume that for the taxable year 1963, W, a mutual insurance company subject to the tax imposed by section 821(a), has an underwriting gain (for purposes of sec. 824(a)) of \$100. Assume further that W’s concentrated windstorm, etc., premium percentage (as determined under sec. 824(a)(2)) for the taxable year is 70 percent, and losses incurred during the taxable year are \$1,000. Under the provisions of section 824(a), W’s deduction for protection against losses for 1963 would be \$55. Of this amount, \$10 (1 percent of losses incurred, or 1 percent of \$1,000) is due to the application of section 824(a)(1)(A), \$25 (25 percent of underwriting gain, or 25 percent of \$100) is due to the application of section 824(a)(1)(B), and \$20—the amount determined by multiplying the underwriting gain by so much of the concentrated windstorm, etc., premium percentage as exceeds 50 percent, or 20 percent (70 percent minus 50 percent) times \$100—is due to the application of section 824(a)(1)(C).

Paragraph (2) of the new section 824(a) defines the term “concentrated windstorm, etc., premium percentage” for any taxable year as the percentage obtained by dividing—

(1) the amount of the premiums earned on insurance contracts during the taxable year (as defined in sec. 832(b)(4)), to the extent attributable to insurance against losses arising in any one State from windstorm, hail, flood, earthquake, or similar hazards, by

(2) the total amount of the premiums earned on insurance contracts during the taxable year (as defined in sec. 832(b)(4)).

For purposes of the preceding sentence the term “similar hazards” includes tornadoes, cyclones, and similar risks against natural phenomena but does not include insurance against fires, explosions, or riots. In the case of a company which issues contracts insuring against a combination of risks, some of which are included under this paragraph and some of which are not included under this paragraph,

a reasonable allocation of the premiums earned for the taxable year with respect to such contracts will be made for purposes of determining such company's concentrated windstorm, etc., premium percentage for the taxable year.

(b) *Protection against loss account.*—Subsection (b) of the new section 824 requires every insurance company subject to the tax imposed by section 821(a) for any taxable year to establish and maintain a protection against loss account. This account is to be established for taxable years beginning after December 31, 1962, and the beginning or opening balance of such account is to be zero.

(c) *Additions to account.*—Subsection (c) of the new section 824 relates to the amount which is to be added to the protection against loss account for each taxable year for which the taxpayer is subject to the tax under section 821(a). Subsection (c) of the new section 824 provides that the amount to be added to the protection against loss account is to be an amount equal to the deduction for protection against losses provided by section 824(a)(1).

(d) *Subtractions.*—Paragraphs (1), (4), and (5) of the new section 824(d) set forth the amounts which are to be subtracted from the protection against loss account. The amount which is required to be subtracted under section 824(d) is taken into account under section 821(b)(1)(C) for purposes of determining mutual insurance company taxable income.

Paragraph (1) of the new section 824(d) provides that, after making the additions required by section 824(c) for the taxable year, there shall be subtracted from the protection against loss account—

(A) first, an amount equal to the excess of the statutory underwriting loss for the taxable year over the underwriting loss (as defined in par. (6)) for the taxable year,

(B) then, the amount (if any) by which—

(i) the sum of the investment loss and the underwriting loss for such taxable year exceeds

(ii) the sum of the statutory underwriting income and the taxable investment income for such taxable year,

(C) next (in the order in which the losses occurred), amounts equal to the unused loss carryovers to such taxable year,

(D) next, any amount remaining which was added to the account for the fifth preceding taxable year, minus one-half of the underwriting gain remaining in the account for such taxable year which was added under subsection (a)(1)(B), and

(E) finally, the amount by which the total amount in the account exceeds whichever of the following is the greater:

(i) 10 percent of premiums earned on insurance contracts during the taxable year (as defined in sec. 832(b)(4)) less dividends to policyholders (as defined in sec. 832(c)(11)), or

(ii) the total amount in the account at the close of the preceding taxable year.

Under subparagraph (A) of the new section 824(d)(1), the first subtraction from the protection against loss account is made for so much of the statutory underwriting loss as is generated either by the deduction for dividends to policyholders (as defined in sec. 832(c)(11)) or by the deduction provided in section 824(a) for protection against losses. For purposes of subparagraph (A) of the new section 824(d)(1), an underwriting loss is not taken into account. The term

“underwriting loss” means a loss which is attributable to the payment of insurance claims and expenses and does not include losses which are attributable to the payment of dividends to policyholders or to the deduction to provide protection against losses.

Under subparagraph (B) of the new section 824(d)(1), the underwriting loss is subtracted from the protection against loss account but only to the extent that such loss exceeds the taxable investment income (as defined in sec. 822(a)(1)) for the taxable year. Subparagraph (B) of the new section 824(d)(1) further provides for a subtraction from the protection against loss account if the investment loss (as defined in sec. 822(a)(2)) for the taxable year, exceeds the statutory underwriting income (as defined in sec. 823(a)(1)) for the taxable year. The effect of this provision is to provide that no portion of an investment loss for any taxable year may be applied against mutual insurance company taxable income for any prior or subsequent taxable year unless the investment loss exceeds the balance in the protection against loss account at the close of the taxable year.

Subparagraph (D) of the new section 824(d)(1) provides for the subtraction of certain amounts added to the protection against loss account for any taxable year under section 824(c) if such amounts remain in the account for the next 5 taxable years. Under subparagraph (D) of the new section 824(d), the entire amount remaining in the account from the fifth preceding taxable year which was added by reason of section 824(a)(1)(A) (relating to deduction for 1 percent of losses incurred during the taxable year) or section 824(a)(1)(C) (relating to additional deduction for certain companies having concentrated windstorm, etc., risks) is to be subtracted from the protection against loss account. There is also to be subtracted under subparagraph (D) of the new section 824(d)(1) an amount representing one-half of the amount remaining in the account with respect to such fifth preceding taxable year which was added by reason of section 824(a)(1)(B) (relating to deduction for 25 percent of underwriting gain for the taxable year).

Subparagraph (E) of the new section 824(d)(1) provides (taking into account the priority rule in sec. 824(d)(3)(B)), in effect, a ceiling on the amount which can be added to and remain in the protection against loss account for the taxable year for which the amount is added. Subparagraph (E) provides that if the total amount in the account (as determined under sec. 824(d)(2)) exceeds the greater of (1) 10 percent of premiums earned on insurance contracts during the taxable year (as defined in sec. 832(b)(4)) less dividends to policyholders (as defined in sec. 832(c)(11)), or (2) the total amount in the account at the close of the preceding taxable year, then the amount of such excess shall be subtracted from the protection against loss account.

Paragraph (2) of the new section 824(d) contains rules for determining the ceiling on the protection against loss account. Paragraph (2) of the new section 824(d) provides that for purposes of paragraph (1)(E) of the new section 824(d), the total amount in the account is to be determined—

- (1) after the application of section 824(d) without regard to paragraph (1)(E) thereof, and

- (2) without regard to amounts remaining in the account which were added, with respect to all taxable years, under section

824(a)(1)(C) (relating to additional deduction to provide protection against losses for certain companies having concentrated windstorm, etc., risks).

Under paragraph (2) of the new section 824(d), for purposes of determining the ceiling on the protection against loss account in the case of a company having concentrated windstorm, etc., risks, any amount added to the account by reason of the application of section 824(a)(1)(C) is not to be taken into account.

Paragraph (3) of the new section 824(d) provides rules relating to the priority in which the subtractions from the protection against loss account are to be made. Under paragraph (3)(A) of the new section 824(d) the amounts required to be subtracted from the protection against loss account under section 824(d)(1) (A), (B), and (C), are to be made—

(1) first (on a first-in, first-out basis) from amounts in the account with respect to the 5 preceding taxable years and the taxable year, and

(2) then from amounts in the account with respect to earlier years.

Under paragraph (3)(B) of the new section 824(d), the amounts required to be subtracted from the protection against loss account under section 824(c)(1)(E) are to be subtracted only from amounts in the account with respect to the taxable year.

Under paragraph (3)(C) of the new section 824(d), if the amount to be subtracted from the total amounts in the account with respect to any taxable year is less than such total, the amount required to be subtracted from the protection against loss account under section 824(d)(1) (A), (B), (C), and (E) is to be subtracted from each of the amounts referred to in section 824(a)(1) in the account with respect to such year in the proportion which each bears to the total amount in the account with respect to such year. For example, assume that for the taxable year 1966, N, a mutual insurance company subject to the tax imposed by section 821(a), is required to subtract \$60 from its protection against loss account under section 824(d)(1) (other than under subpar. (E)). Assume that the total amount in the account for 1963 (the first preceding taxable year for which additions to the account were made) is \$100. Assume further that of this \$100 balance, \$30 is due to the application of section 824(a)(1)(A), \$50 is due to the application of section 824(a)(1)(B), and \$20 is due to the application of section 824(a)(1)(C). Under paragraph (3)(C) of the new section 824(d), since the amount to be subtracted from the balance in the account with respect to 1963 is less than such balance, the amount to be subtracted from each of the amounts in the account with respect to such taxable year shall be in the proportion which each bears to such total. Accordingly, the amount in the account by reason of the application of section 824(a)(1)(A) shall be reduced by \$18 ($30/100 \times \60). The amount in the account with respect to the application of section 824(a)(1)(B) shall be reduced by \$30 ($50/100 \times \60). The amount in the account with respect to the application of section 824(a)(1)(C) shall be reduced by \$12 ($20/100 \times \60).

Paragraph (4) of the new section 824(d) provides that if the taxpayer is not subject to tax under part II of subchapter L for any taxable year, the entire amount in the protection against loss account at the close of the preceding taxable year is to be subtracted from the account

in such preceding taxable year and included in mutual insurance company taxable income (as defined in sec. 821(b)) for such preceding taxable year.

Paragraph (5) of the new section 824(d) provides that for any taxable year for which the company is subject to the tax imposed by section 821(a), it may elect to subtract from its protection against loss account any amount which, except for the application of this election, would be in such account as of the close of such taxable year. The amount elected to be subtracted from the protection against loss account is to be included in mutual insurance company taxable income (as defined in sec. 824(b)) for the taxable year. The election must be made after the close of the taxable year for which it is to apply and not later than the time prescribed by law for filing the return (including extensions thereof) for the taxable year following such taxable year, and in such manner and form as the Secretary or his delegate may by regulations prescribe. The election is to apply only with respect to the taxable year for which it is made and once such an election has been made it may not subsequently be revoked.

Paragraph (6) of the new section 824(d) defines the term "underwriting loss" for purposes of determining the amount of the subtractions required to be made under section 824(d)(1) (A) and (B). The term means the amount by which—

(1) the deductions which would be taken into account in computing taxable income under section 832 if the taxpayer were subject to the tax imposed by section 831, reduced by the sum of—

(A) the deductions provided in section 822(c) (relating to deductions in computing taxable investment income), and

(B) the deduction for dividends to policyholders provided by section 832, exceeds

(2) the amount referred to in section 823(a)(1)(A).

Examples.—The application of the new section 824(d) may be illustrated by the following examples:

Example (1): For the taxable year 1969, X, a mutual insurance company subject to the tax imposed by section 821(a), has a statutory underwriting loss of 22, including dividends to policyholders of 20 and a protection against loss deduction of 7 (which is entirely attributable to the application of section 824(a)(1)(A)). The following table shows the protection against loss account of X before and after the application of section 824(d) for the taxable year 1969:

	1963	1964	1965	1966	1967	1968	1969
Protection against loss account:							
Balance remaining in account with respect to each taxable year (before application of sec. 824(d))-----	3	2	4	5	4	3	7
Balance remaining in account with respect to each taxable year (after application of sec. 824(d))-----	3	0	0	0	0	0	3

Under the provisions of section 824(d)(1)(A), X would subtract 22 (the amount by which the statutory underwriting loss exceeds the underwriting loss, or 22 minus 0) from its protection against loss account for the taxable year 1969. Under the provisions of section

824(d)(3)(A), since the subtractions are to be made with respect to amounts in the account for the 5 preceding taxable years and the taxable year on a first-in, first-out, basis, X would first apply the amount to be subtracted to the amounts in the account with respect to 1964, 1965, 1966, 1967, and 1968, in that order. This would reduce the total amount in the account with respect to such taxable years by 18, and the balance in the account with respect to each of the taxable years 1964 through 1968 would be reduced to zero. The remaining amount required to be subtracted under section 824(d)(1)(A), 4 (22 minus 18), would then be subtracted from the amount added to the account for the taxable year, 7 (an amount equal to the protection against loss deduction for the taxable year 1969), leaving a balance of 3 (7 minus 4) in the account with respect to 1969. No proration of the subtraction from the amount in the account for 1969 is required under section 824(d)(3)(C) since the entire amount added to the account in 1969 was added by reason of section 824(a)(1)(A).

Example (2): Assume the facts are the same as in example (1), except that X has a statutory underwriting loss of 27 for the taxable year 1969. After the application of section 824(d) for the taxable year 1969, the results would be as follows:

Protection against loss account

	1963	1964	1965	1966	1967	1968	1969
Balance remaining in account with respect to each taxable year (after application of sec. 824(d))-----	1	0	0	0	0	0	0

Under the provisions of section 824(d)(1)(A), X would subtract 27 (the amount by which the statutory underwriting loss exceeds the underwriting loss, or 27 minus 0) from its protection against loss account for the taxable year 1969. This subtraction would be made (on a first-in, first-out, basis) under section 824(d)(3)(A)(i) from amounts in the account with respect to 1964, 1965, 1966, 1967, 1968, and 1969, in that order. This would reduce the total amount in the account with respect to such taxable years by 25, and the balance in the account with respect to each of the taxable years 1964 through 1969 would be reduced to zero. Under the provisions of section 824(d)(3)(A)(ii), the remaining amount required to be subtracted under section 824(d)(1)(A), 2 (27 minus 25), would then be subtracted from the amount in the account with respect to 1963 (i.e., the amount representing one-half of the amount added by reason of section 824(a)(1)(B) which was not required to be subtracted from the protection against loss account under section 824(d)(1)(D) in 1968). Thus, the amount in the account with respect to 1963 would be reduced to 1 (3 minus 2).

Example (3): Assume that Y, a mutual insurance company subject to tax under section 821(a), has a protection against loss account which reflects the following additions for the taxable years 1963 through 1968:

Additions to protection against loss account

	1963	1964	1965	1966	1967	1968
Additions:						
1 percent of losses incurred.....	15	20	60	60	60	60
25 percent of underwriting gain.....	60	20	40	50	45	45
Additional deduction for concentrated risks.....	0	0	5	5	0	0
Total.....	75	40	105	115	105	105

Y, in computing mutual insurance company taxable income for 1968, is required to subtract from the account with respect to 1963 the entire amount of the 1 percent of losses incurred added for 1963 (15) and one-half of the underwriting gain (30) added for such year. Upon taking into account these subtractions, the balance in the protection against loss account with respect to 1963 is 30 (the one-half remaining in the account after the application of paragraph (1)(D) of section 824(d)).

Assume further, that for the taxable year 1969, Y has taxable investment income of 50, underwriting gain of 80, incurred losses of 5,000, and premiums earned less dividends to policyholders of 5,080. Under section 824(a), the protection against loss deduction for 1969 is 60. After applying section 824(c), but before applying section 824(d) for 1969, the protection against loss account as of the close of 1969 (after subtracting in 1968 the 45 amount with respect to 1963) would be as follows:

Protection against loss account

	1963	1964	1965	1966	1967	1968	1969
Additions:							
1 percent of loss incurred.....	0	20	60	60	60	60	40
25 percent of underwriting gain.....	30	20	40	50	45	45	20
Additional deduction for concentrated risks.....	0	0	5	5	0	0	0
Total with respect to taxable year.....	30	40	105	115	105	105	60
Total (as of end of each year before 1969 subtractions).....	30	70	175	290	395	500	560

After making the addition to the protection against loss account for 1969 and obtaining the results shown in the table above, Y is required to make the subtractions for 1969 from the account. These subtractions may be summarized as follows:

Subtractions under sec. 824(d) for 1969

Taxable year with respect to which amount is subtracted	1963	1964	1965	1966	1967	1968	1969
Par. (1)(A) subtraction.....	0	0	0	0	0	0	0
Par. (1)(B) subtraction.....	0	0	0	0	0	0	0
Par. (1)(C) subtraction.....	0	0	0	0	0	0	0
Par. (1)(D) subtraction.....	0	130	0	0	0	0	0
Par. (1)(E) subtraction.....	0	0	0	0	0	0	12
Pars. (4) and (5) subtraction.....	0	0	0	0	0	0	0

¹ \$20 represents the amount added for 1964 with reference to incurred losses; \$10 represents one-half of the amount added for 1964 with reference to underwriting gain.

After determining the subtractions with respect to years before 1969, the next step is to determine whether any subtraction is required for the taxable year 1969 under section 824(d)(1)(E). Since the total balance in the account after the application of section 824(d) (other than paragraph (1)(E) thereof), 520 (560 minus 30, and excluding 10 added to the account by reason of the additional deduction for protection against losses for concentrated windstorm, etc., companies provided by section 824(a)(1)(C)), exceeds 10 percent of premiums earned on insurance contracts during the taxable year less dividends to policyholders, 508 (10 percent of 5,080), Y would be subject to the ceiling on the protection against loss account for the taxable year 1969 and would be required to subtract 12 (the excess of 520 over 508) from the account under section 824(d)(1)(E). Under the provisions of section 824(d)(3)(B) this subtraction would be made only from amounts in the account with respect to the taxable year. 1969. Under the provisions of section 824(d)(3)(C), however, since the amount to be subtracted, 12, is less than the total amount added to the account for the taxable year, 60 (40 plus 20), the subtractions under section 824(d)(1)(E) would be applied ratably against each of the amounts added to the account for the taxable year. Thus, the amount remaining in the account with respect to section 824(a)(1)(A) for the taxable year 1969, would be 32 (40 minus $40/60 \times 12$, or 40 minus 8), and the amount remaining in the account with respect to section 824(a)(1)(B) for the taxable year 1969, would be 16 (20 minus $20/60 \times 12$, or 20 minus 4).

Based on these facts, Y's mutual insurance company taxable income for 1969 would be 112 (the sum of taxable investment income of 50, plus statutory underwriting income of 20 (underwriting gain minus protection against loss deduction, or 80 minus 60), plus subtractions from the protection against loss account under section 824(d) of 42).

SECTION 825. UNUSED LOSS DEDUCTION

(a) *Amount of deduction.*—Subsection (a) of the new section 825 provides that, for purposes of part II of subchapter L, the unused loss deduction (used in the determination of mutual insurance company taxable income under section 821(b)) shall be an amount equal to the unused loss carryovers and carrybacks to the taxable year.

(b) *Unused loss defined.*—Subsection (b) of the new section 825 defines the term “unused loss,” for purposes of part II of subchapter L, as the amount by which—

(1) the sum of the statutory underwriting loss (as defined in sec. 823(a)(2)) and the investment loss (as defined in sec. 822(a)(2)), exceeds—

(2) the sum of—

(A) the taxable investment income (as defined in sec. 822(a)(1)),

(B) the statutory underwriting income (as defined in sec. 823(a)(1)), and

(C) the amounts required to be subtracted from the protection against loss account under section 824(d).

If the sum of the items under (1) does not exceed the sum of items under (2), the unused loss is zero.

(c) *Loss year defined.*—Subsection (c) of the new section 825 defines as the loss year, for purposes of part II of subchapter L, any taxable year in which a company subject to the tax imposed by section 821(a) has an unused loss which is more than zero.

(d) *Years to which carried.*—Subsection (d) provides that the unused loss for any loss year is to be an unused loss carryback to each of the 3 taxable years preceding the loss year and an unused loss carryover to each of the 5 taxable years following the loss year. For certain taxable years to or from which an unused loss may not be carried, see section 825(g).

(e) *Amount of carrybacks and carryovers.*—Subsection (e) of the new section 825 provides that for any loss year, the entire amount of the unused loss, determined under the provisions of section 825(b), shall be carried to the earliest of taxable years to which such loss may be carried under section 825(d) (subject to the limitations of section 825(g)). The amount of the unused loss permitted under section 825(d), carried under section 825(d) to each of the other taxable years, following the earliest taxable year shall be the excess of such loss over the sum of the offsets for each taxable year preceding the taxable year to which the loss is carried.

(f) *Offset defined.*—Subsection (f) of the new section 825 defines the term “offset,” for purposes of section 824(e) and provides that the taxable year to which an unused loss is carried is to be referred to as the “offset year.” “Offset” is defined as the mutual insurance company taxable income for the offset year in the case of an unused loss carryback from the loss year to the offset year. In the case of an unused loss carryover from the loss year to the offset year, the offset is the sum of the amount required to be subtracted from the protection against loss account under section 824(d)(1)(C) for the offset year and the mutual insurance company taxable income for the offset year. For purposes of computing the offset, the mutual insurance company taxable income for the offset year (as defined in section 821(b)) shall be determined without regard to any loss carryback or carryover to the offset year from the loss year, or any year thereafter.

Example: The application of section 825 may be illustrated by the following example:

For the taxable year 1967, F, a mutual insurance company subject to the tax imposed by section 821(a), has the following items:

Taxable investment income	1
Underwriting loss	59
Addition to protection against loss account	8
Dividends to policyholders	0
Statutory underwriting loss	67

As explained below, the subtractions from protection against loss account are as follows:

Amount subtracted from amounts in account with respect to taxable years 1963 through 1966	18
Amount subtracted from amounts in account with respect to taxable year 1967	8

Total subtractions from protection against loss account under sec. 824(d)	26
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The application of section 825 in this case may be illustrated by the facts and results shown in the following table and explained below:

	Taxable year—					
	1963	1964	1965	1966	1967	1968
Protection against loss account:						
Addition to account during taxable year.....	6	2	3	7	8	7
Subtraction from account during taxable year.....	0	0	0	0	8	7
Protection against loss account (at end of year).....	6	2	3	7	0	0
Protection against loss account (at end of taxable year 1968).....	0	0	0	0	0	0
Unused loss.....	0	0	0	0	40	0
Unused loss carryback.....	0	40	35	25	0	0
Unused loss carryover.....	0	0	0	0	0	18
Unused loss deduction.....	0	40	35	25	0	18
Mutual insurance company taxable income (computed without regard to unused loss).....	13	5	10	7	0	2
Mutual insurance company taxable income (computed with regard to unused loss).....	13	0	0	0	0	0
Offset for year.....	0	5	10	7	0	9
Offset total.....	0	5	15	22	0	31

1967: Under the provisions of section 825(b), F's unused loss for 1967 is 40, the amount by which the sum of the statutory underwriting loss and the investment loss, 67 (67 plus 0), exceeds the sum of the taxable investment income, the statutory underwriting income, and the amounts required to be subtracted from the protection against loss account under section 824(d) for the taxable year, 27 (the sum of 1, 0, and 26, respectively).

1967 carryback to 1964: Under the provisions of section 825(e), the entire unused loss for 1967 of 40 is carried back to 1964, the earliest year to which the loss may be carried under section 825(d). Since there are no other amounts carried to 1964, the unused loss deduction for 1964 is 40. Thus, after taking the unused loss deduction into account, the mutual insurance company taxable income for 1964 is zero, and the offset for 1964 is 5 (the mutual insurance company taxable income for 1964 determined without regard to the unused loss carryback from 1967 or any year thereafter).

1967 carryback to 1965: The portion of the unused loss for 1967 which is carried back to 1965 is 35 (40 minus 5, the offset for 1964). After taking the underwriting loss deduction into account, the mutual insurance company taxable income for 1965 is zero. The offset for 1965 is 10, the mutual insurance company taxable income for 1965 determined without regard to any unused loss carryback or carryover from 1967 or any year thereafter.

1967 carryback to 1966: The portion of the unused loss for 1967 which is carried back to 1966 is 25. This amount is the excess of the underwriting loss for 1967 of 40 over the sum of the offset for 1965 (5) and the offset for 1966 (10). Thus, as a result of the unused loss for 1967, the mutual insurance company taxable income for 1966 is reduced to zero. The offset for 1966 is 7.

1967 carryover to 1968: Under the provisions of section 825(d), the portion of the unused loss for 1967 which is carried forward to 1968 is 18 (40 minus the sum of 10, 5, and 7, the offsets for 1964, 1965, and 1966, respectively). Under section 825(f)(2), this amount is first applied against any amounts in the protection against loss account at the end of 1968, and is then applied against the mutual insurance

company taxable income for 1968. Thus, assuming that there are no other subtractions from its protection against loss account under section 824(d) for 1968, F's protection against loss account of 7 is reduced to zero by reason of the subtraction under section 824(d)(1)(C). The remaining portion of the unused loss for 1967 which is carried to 1968, 11 (18 minus 7, the amount of the unused loss carryover to 1968 which is subtracted from the protection against loss account under sec. 824(d)(1)(C)), is then applied against the mutual insurance company taxable income for 1968. Thus, after the application of the unused loss deduction for 1968, the mutual insurance company taxable income for 1968 is zero. The offset for 1968 is 9, the sum of the amount required to be subtracted from the protection against loss account under section 824(d)(1)(C) for 1968 (7), plus the mutual insurance company taxable income for 1968, determined without regard to the unused loss carryover from 1967 or any unused loss carry-back from 1967 or any year thereafter (2). The remaining 9 of the unused loss for 1967 (40 minus the sum of 10, 5, 7, and 9, the offsets for 1964, 1965, 1966, and 1968, respectively) is carried forward to 1969, and to the extent not used in that year or any year thereafter, may be carried forward to 1970, 1971, and 1972, in that order.

(g) *Limitations.*—Subsection (g) of the new section 825 provides that, for purposes of part II of subchapter L, an unused loss (as defined in sec. 825(b)) may not be carried—

(1) to or from any taxable year beginning before January 1, 1963;

(2) to or from any taxable year for which the insurance company is not subject to tax imposed by section 821(a); nor

(3) to any taxable year if, between the loss year and such taxable year, there is an intervening taxable year for which the insurance company was not subject to the tax imposed by section 821(a).

Examples.—The application of section 825(g) may be illustrated by the following:

Example (1.)—For the taxable year 1963, M, a mutual insurance company subject to tax imposed by section 821(a), has an unused loss (as defined in sec. 825(b)) of \$65,000. The loss may not be carried back to any taxable year beginning before 1963. However, the loss may be carried forward to each of the 5 taxable years following 1963 provided that for each of such succeeding taxable years M is subject to the tax imposed by section 821(a).

Example (2.)—Assume the facts are the same as in example (1), except that for the taxable year 1964, the gross amount received by M from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) exceeds \$75,000 but does not exceed \$300,000. If M does not make the election under section 821(d) (relating to election to be taxed under sec. 821(a) for 1964), the loss will not be allowed as an unused loss carryover since, by reason of section 825(g)(3), the unused loss may not be carried to any taxable year if, between the loss year and such taxable year, there is an intervening taxable year for which the insurance company was not subject to the tax imposed by section 821(a), and by reason of section 825(g)(1), the unused loss may not be carried to any taxable year beginning before 1963.

SECTION 826. ELECTION BY RECIPROCAL

(a) *In general.*—Subsection (a) of the new section 826 provides that, except as provided in section 826(c), any insurance company which is an interinsurer or reciprocal underwriter (referred to in sec. 826 as a “reciprocal”) subject to the tax imposed by section 821(a), may elect to be subject to the limitation provided in subsection (b) of the new section 826. Such election shall be made, under regulations prescribed by the Secretary or his delegate, not later than the time prescribed by law (including extensions thereof) for filing the return for the year for which such election is first to apply. The election is to apply for the taxable year for which made and for all succeeding taxable years and may not be revoked without the consent of the Secretary or his delegate. The effect of such election is to increase the income of the reciprocal by the income of its attorney-in-fact attributable to the reciprocal for purposes of computing the taxes imposed by section 821(a) and to allow such reciprocal a credit for the taxes paid by the attorney-in-fact with respect to the income attributed to the reciprocal.

(b) *Limitation.*—Subsection (b) of the new section 826 provides that a reciprocal making the election provided under section 826(a) shall limit the deduction for amounts paid or incurred in the taxable year to the attorney-in-fact to such amounts as are deductible by the attorney-in-fact in respect of the income received by the attorney-in-fact from the reciprocal. In no case may such deduction of the reciprocal be increased by the deductions of the attorney-in-fact allocable to the income received from the reciprocal.

(c) *Exception.*—Section 826(c) provides that no election under section 826(a) may be made by a reciprocal unless its attorney-in-fact—

(1) is a corporation subject to the taxes imposed by section 11 (b) and (c) of subtitle A;

(2) consents to make available such information as may be required during the period in which an election made under subsection (a) is in effect;

(3) reports income received from the reciprocal and deductions allocable thereto under the same method of accounting used by the reciprocal in reporting deductions for amounts paid or incurred to the attorney-in-fact; and

(4) files its return on a calendar year basis.

(d) *Special rule.*—Subsection (d) of the new section 826 provides that the limitation under section 826(b) shall not be taken into account by any reciprocal electing under section 826(a) for purposes of computing the protection against loss deduction provided in section 824(a) and for purposes of computing the addition to the protection against loss account provided in section 824(c). Thus, in effect, a reciprocal making the election shall not take into account any of the income of the attorney-in-fact for purposes of computing its protection against loss deduction.

(e) *Credit*.—Subsection (e) of the new section 826 provides that any reciprocal electing to be subject to the limitation provided in subsection (b) shall be credited with the tax paid by its attorney-in-fact with respect to the income of the reciprocal in such taxable year.

(f) *Surtax exemption denied*.—Subsection (f) of the new section 826 provides that any tax imposed upon the increase in the income of the reciprocal attributable to the limitation under subsection (b) shall be computed without regard to the \$25,000 surtax exemption provided in section 821(a)(2).

(g) *Adjustment for refund*.—Subsection (g) of the new section 826 provides that if for any taxable year an attorney-in-fact is allowed a credit or refund for taxes paid with respect to which a reciprocal was allowed a credit or refund under subsection (e) of the new section 826, the taxes of the reciprocal for the year in which such credit or refund is allowed shall be properly adjusted under regulations prescribed by the Secretary or his delegate. This adjustment prevents the reciprocal and the attorney-in-fact from obtaining a credit or refund with respect to the same tax.

For example, assume that a reciprocal has elected in 1963 to be subject to the limitation provided in section 826(b) and such election is still in effect in taxable year 1966. Assume further that in taxable year 1969 its attorney-in-fact receives a refund or credit with respect to taxable year 1966. In such case, the taxes of the reciprocal in taxable year 1969 shall be properly adjusted under regulations prescribed by the Secretary or his delegate.

(h) *Taxes of attorney-in-fact unaffected*.—Subsection (h) of the new section 826 provides that nothing in section 826 shall either increase or decrease the taxes imposed by chapter 1 on the income of the attorney-in-fact.

Example.—The application of section 826 may be illustrated by the following example:

For the taxable year 1963, R, a reciprocal underwriter subject to the taxes imposed by section 821(a), has the following items (determined before applying any election under sec. 826):

Gross income under sec. 832.....	578
Gross investment income.....	50

Deductions under sec. 832 (as modified by sec. 823(b)):

Deduction for amounts paid by R to attorney-in-fact A.....	100
All other deductions.....	500

Total deductions under sec. 832.....	600
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Deductions under sec. 822(c).....	40
Incurred losses.....	400
Protection against loss deduction.....	4
Underwriting gain.....	0
Mutual insurance company taxable income.....	0
Unused loss.....	22
Credit or refund for taxes paid.....	0

Assume that the deductions of attorney-in-fact A allocable to the income received by A from R are 60 and the tax paid by A allocable to the income received from R is 16. If R elects to be subject to the

limitation provided in section 826(b), the results for 1963 would be as follows:

Gross income under sec. 832.....	578
Gross investment income.....	50
Deductions under sec. 832 (as modified by sec. 823 (b)):	
Deduction for amounts paid by R to attorney-in-fact A.....	60
All other deductions.....	500
Total deductions under sec. 832.....	560
Deductions under sec. 822(c).....	40
Incurring losses.....	400
Protection against loss deduction.....	4
Underwriting gain.....	8
Mutual insurance company taxable income.....	14
Unused loss.....	0
Credit or refund for taxes paid.....	16

Under the provisions of section 826(b), R's deduction for amounts paid or incurred to the attorney-in-fact in the taxable year 1963 would be limited to the deductions of A allocable to the income received by A from R. Thus, R's deductions under section 832 (as modified by sec. 823(b)) for 1963 would be 60 (the deductions of A which are allocable to the income received by A from R). As a result of making the election under section 826(a) for the taxable year 1963, R's underwriting gain would be 8, and its statutory underwriting income would be 4 (the underwriting gain of 8 minus the protection against loss deduction under section 824(a)(1)(A) representing 1 percent of losses incurred of 4, or 8 minus 4). Accordingly, R's mutual insurance company taxable income for 1963 would be 14. This amount consists of the taxable investment income of 10 (gross investment income minus deductions under sec. 822(c), or 50 minus 40) plus the statutory underwriting income of 4. Since all of R's mutual insurance company taxable income of 14 is attributable to the limitation under section 826(b), the entire amount is subject to the surtax under section 821(a)(2) without regard to the \$25,000 surtax exemption. The credit of 16, representing that part of the taxes paid by A which is allocable to the income received by A from R, may be applied by R against its taxes with respect to its mutual insurance company taxable income of 14 for 1963, and R would be entitled to a refund of any excess of the amount of such credit over its tax liability for 1963.

SECTION 10. MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE, MARINE, AND CERTAIN FIRE INSURANCE COMPANIES), ETC. (Continued)

(d) *Mutual fire insurance companies operating on basis of premium deposits.*—Subsection (d) of section 10 of the bill amends section 831(a) of the 1954 Code to include mutual fire insurance companies operating on the basis of premium deposits among the companies which are subject to the tax imposed by part III of subchapter L of chapter 1 of the code.

(1) *Application of section 831(a).*—Subsection (d)(1) of section 10 of the bill amends section 831(a) of the code (which imposes a tax on certain mutual marine and mutual fire insurance companies and on stock insurance companies which are not life insurance companies)

to provide that, for taxable years beginning after December 31, 1962, mutual fire insurance companies operating on the basis of premium deposits are to be subject to tax under part III of subchapter L. Under existing law, mutual fire insurance companies operating on the basis of premium deposits (the so-called factory mutual insurance companies) are taxed in the same manner as any other mutual insurance company (other than a life or marine or fire insurance company issuing perpetual policies). Thus, these companies are subject to the tax imposed by section 821. (See *Philadelphia Manufactures Mutual Insurance Company v. Commissioner* (1959), 33 T.C. 490, aff'd (C.A. 3d 1960) 284 F. 2d 296.) Under the bill, every mutual fire insurance company whose principal business is the issuance of policies for which the premium deposits are the same, regardless of the length of the term for which the policies are written, will be subject to the tax imposed by section 831(a) if the unabsorbed portion of such premium deposits not required for losses, expenses, or establishment of reserves is returned or credited to the policyholder on cancellation or expiration of the policy.

(2) *Treatment of unabsorbed premium deposits.*—Subsection (d)(2) of section 10 of the bill amends section 832(b)(4) of the code (relating to definition of premiums earned) to provide that for purposes of determining the premiums earned on insurance contracts during the taxable year in the case of a mutual fire insurance company operating on the basis of premium deposits, the term “unearned premiums” means (with respect to the policies described in section 831(a)(3)(B)) the amount of unabsorbed premium deposits which the company would be obligated to return to its policyholders at the close of the company's taxable year if all of such policies were terminated at such time. This paragraph further provides that for purposes of determining the amount which such company would be obligated to return to its policyholders at the close of any taxable year, the company must use its own schedule of unabsorbed premium deposit returns then in effect.

(3) *Conforming amendments.*—Subparagraph (d)(3) of section 10 of the bill amends section 832(b)(1)(C) of the code (relating to definition of gross income) to conform to the amendment to section 831(a).

(4) *Adjustment of premium deposit.*—Subparagraph (d)(4) of section 10 of the bill amends section 832(c)(11) of the code (relating to deduction for dividends to policyholders) to provide that the term “dividends and similar distributions” includes amounts returned or credited to policyholders on cancellation or expiration of factory mutual policies described in the new section 831 (a)(3)(B).

(5) *Additional item of income.*—Subparagraph (d)(4) of section 10 of the bill amends section 832(b)(1) of the code (relating to the definition of gross income) to provide that, in the case of a mutual fire insurance company operating on the basis of premium deposits, gross income includes an amount which is equal to 2 percent of premium earned on insurance contracts during the taxable year with respect to policies described in section 831(a)(3)(B) after deduction of premium deposits returned or credited during the same taxable year. The term premiums earned on insurance contracts during the taxable year for purposes of this section means the absorbed premiums for the taxable year determined in accordance with the schedule of unabsorbed premium deposits in effect at the end of the taxable year.

(e) *Election of certain mutual companies to be taxed on total income.*—Subsection (e) of section 10 of the bill amends section 831 of the code (relating to tax on insurance companies (other than life or mutual), mutual marine insurance companies, and mutual fire insurance companies issuing perpetual policies) by redesignating subsection (c) as subsection (d) and adding a new subsection (c). The new section 831(c) provides that any mutual insurance company engaged in writing marine, fire, and casualty insurance which for any 5-year period beginning after December 31, 1941, and ending before January 1, 1962, was subject to the tax imposed by section 831 (or the tax imposed by corresponding provisions of prior law) may elect to be subject to the tax imposed by section 831, whether or not marine insurance is its predominant source of premium income. If such election is made, the electing company shall be subject to the tax imposed by section 831, for years beginning after December 31, 1961, rather than subject to the tax imposed by section 821. Such election shall not be revoked except with the consent of the Secretary or his delegate.

(f) *Technical amendments, etc.*—This subsection makes certain technical changes to provisions of the 1954 Code outside of parts II or III of subchapter L to conform those provisions to the changes in subchapter L made by section 10 of the bill.

(1) *Credit for foreign taxes.*—Subsection (f)(1) amends section 841 of the code (providing for the allowance to an insurance company of the foreign tax credit provided in section 901) so as to define the term “taxable income,” as used in section 904, to mean the mutual insurance company taxable income (as defined in sec. 821(b)) in the case of the tax imposed by section 821(a), and the taxable investment income (as defined in sec. 822(a)(1)) in the case of the tax imposed by section 821(c).

(2) *Adjustments to basis for depreciation sustained.*—Subsection (f)(3) amends section 1016(a)(3) of the code (relating to adjustments to basis for depreciation, etc., sustained) to provide, in effect, that any exhaustion, wear and tear, obsolescence, amortization, and depreciation, to the extent sustained (and to the extent sec. 1016(a)(2) does not apply), on property held in respect of any period since February 28, 1913, by a person subject to tax under part II of subchapter L (or the corresponding provisions of prior income tax laws), must be taken into account in determining the adjusted basis of such property.

(3) *Alternative tax on capital gains.*—Subsection (f)(2) amends section 1201(a) of the code (relating to alternative tax on capital gains) to conform to the amendment to section 821.

(4) *Clerical amendments.*—Subsection (f)(4) makes conforming changes to the table of parts for subchapter L.

(g) *Effective date.*—Subsection (g) of section 10 of the bill provides that the amendments made by section 10 of the bill (other than by subsec. (e)) shall apply only with respect to taxable years beginning after December 31, 1962. Section 831(c) of the code, as added by subsection (e) of section 10, is applicable for taxable years beginning after December 31, 1961.

SECTION 11. DOMESTIC CORPORATIONS RECEIVING DIVIDENDS FROM FOREIGN CORPORATIONS

Section 11 of the bill deals with the method to be used for determining the amount of foreign income tax deemed to have been paid by domestic corporations with respect to dividends received from foreign corporations for purposes of allowance of a foreign tax credit under section 902 of the code. The bill amends the formulas of subsections 902 (a) and (b), redefines the term "accumulated profits" in section 902(c), and requires (under a new sec. 78) the inclusion of taxes deemed paid in income as a dividend. It also repeals section 902(d) which provides a special rule for allowance of a foreign tax credit with respect to royalty or compensation payments made by certain wholly-owned foreign subsidiaries to domestic parents in lieu of dividends, and changes the source of income rule of section 861(a)(2)(B) with respect to dividend income received from a foreign corporation which derived income from sources within the United States and for which a dividends received deduction was allowed under section 245.

(a) *Entire amount of foreign tax to be taken into account.*—Subsection (a)(1) of section 11 of the bill amends the definition of accumulated profits contained in section 902(c) of the 1954 Code. Existing law defines accumulated profits as gains, profits, or income reduced by the amount of taxes with respect thereto. Under the amendment, however, accumulated profits are defined as gains, profits, or income computed without reduction by the amount of the income, war profits, and excess profits taxes imposed by a foreign country or possession of the United States on or with respect to such profits or income. Taxes imposed by the United States will, however, continue to reduce such accumulated profits.

By redefining accumulated profits, the effect of the amendment is to increase the amount of taxes to be taken into account in applying the proportions provided in sections 902 (a) and (b) of the code. Under existing law, a credit is allowed to a domestic corporation for all or a part of the foreign taxes paid on or with respect to the accumulated profits of the foreign corporation making a distribution. However, by the existing definition, accumulated profits are total profits less taxes thereon. The Supreme Court, in *American Chicle Co. v. United States*, 316 U.S. 450 (1942), has held that the amount of tax paid on or with respect to a foreign corporation's accumulated profits is the same proportion of total taxes on profits as accumulated profits is of total profits. Thus, if a corporation had total profits of \$100, foreign taxes of \$40, and therefore accumulated profits of \$60, the amount of taxes paid on or with respect to accumulated profits would be \$24 ($\$40 \times \$60 / \100). If the accumulated profits of \$60 were paid as a dividend, no more than \$24 could be allowed as a credit as deemed paid under section 902 (a) or (b).

As amended, the section 902(c) definition will permit the taking into account of a stated proportion of total taxes. It is no longer necessary to apply the *American Chicle* rule. Since accumulated profits would be total profits without reduction for taxes paid thereon, the amount of taxes paid on or with respect to accumulated profits would, in the above example, be \$40 rather than \$24.

Subsection (a)(2) of section 11 of the bill makes conforming amendments to the existing subsections (a) and (b) of section 902 to provide for the use of the proportion which distributed dividends bear to the accumulated profits in excess of foreign taxes. The result is to continue under such subsections the use of the ratios under existing law, but because of the amendment to section 902(c) the amount against which the ratios operate is increased.

The application of these changes in a section 902(a) computation may be illustrated by the following example involving Corporation P, a domestic corporation which owns 100 percent of the voting stock of Corporation FC, a foreign corporation. It is assumed that all transactions have taken place within, and are related to, the same taxable year.

Example (1)

(i) Gains, profits, and income of Corporation FC-----	\$100
(ii) Foreign tax paid by Corporation FC with respect to such gains, profits, and income-----	30
(iii) Accumulated profits of Corporation FC computed without reduction for foreign taxes (sec. 902(c))-----	100
(iv) Accumulated profits of Corporation FC reduced by foreign taxes (sec. 902(a))-----	70
(v) Dividends paid by Corporation FC to Corporation P-----	35
(vi) Corporation P is deemed to have paid the same proportion of the total tax paid by Corporation FC as dividends, determined without regard to section 78, bear to accumulated profits in excess of taxes: \$30×35/70-----	15

Example (1) will apply to all dividends received by a domestic corporation after December 31, 1964, regardless of the year in which the profits from which such dividends were paid were accumulated. Example (1) will also apply with respect to dividends received by a domestic corporation in its taxable years beginning after December 31, 1962, so long as the dividends from the foreign corporation are attributable to accumulated profits of the foreign corporation for its taxable years beginning after December 31, 1962. However, for periods before January 1, 1965, the *American Chicle* rule and the present 902(a) treatment will continue to apply where the dividends from the foreign corporation are attributable to accumulated profits for taxable years beginning before January 1, 1963. Following the established rule, a foreign corporation is considered to be making a distribution first from its accumulated profits for its current taxable year and then from its accumulated profits of its immediately preceding year, etc.

The following example illustrates the above rules where a dividend is distributed out of both accumulated profits for taxable years beginning after December 31, 1962, and accumulated profits for taxable years beginning before January 1, 1963. The facts are the same as in example (1) except for the noted differences:

Example (2)

(i) Gains, profits, and income of Corporation FC in 1963-----	\$100
(ii) Foreign tax paid by Corporation FC with respect thereto-----	40
(iii) 1962 accumulated profits and foreign tax:	
Accumulated profits (existing sec. 902(c))-----	60
Foreign tax-----	40
(iv) Dividends paid by Corporation FC to Corporation P in 1963 and the year to which such dividends are attributable:	
1963-----	\$60
1962-----	30
	90
(v) Corporation P is deemed to have paid a foreign tax with respect to the 1963 accumulated profits of Corporation FC computed in the same manner as in example (1) ($\$40 \times 60/60$)-----	40
(vi) Corporation P is deemed to have paid a foreign tax with respect to the 1962 accumulated profits of Corporation FC in the same manner as existing rules ($\$40 \times 60/100 \times 30/60$)-----	12
(vii) Total foreign tax Corporation P is deemed to have paid ((v) + (vi))--	52

Section 902 as amended by section 11 of the bill, when applied to dividends received after December 31, 1964, will not be affected by the fact that there may have been in an earlier year a partial distribution of accumulated profits to which the *Chicle* rule applied. For example, if a wholly-owned foreign subsidiary of a domestic corporation had total profits of \$100, upon which foreign taxes of \$40 had been paid, accumulated profits under existing law would be \$60. Under the *Chicle* rule the taxes paid with respect to the accumulated profits would be \$24 ($\$40 \times \$60/100$). Upon a distribution of one-half (\$30) of such accumulated profits the domestic parent would be entitled under existing section 902(a) to a maximum credit of \$12. However, if at any time after 1964, the subsidiary distributes another dividend, \$30, with respect to the accumulated profits of such earlier year, and taxes deemed paid, determined in accordance with section 902(a), as amended, will be the same proportion of total taxes as the dividend bears to accumulated profits in excess of foreign taxes. Thus, the total tax of \$40 would be multiplied by the fraction 30/60 and the parent would be entitled under section 902(a) as amended to a credit of \$20. No account is to be taken of the foreign tax of \$8 which, because of the *Chicle* rule, was not taken into account in the earlier dividend year.

The new rules effective under section 902(a) will be also effective under section 902(b). Thus, if a dividend from a foreign corporation is distributed out of its accumulated profits for a taxable year beginning after 1962, and such accumulated profits are composed in whole or in part of dividends which were received from accumulated profits of a foreign subsidiary of the foreign corporation accumulated in taxable years beginning after 1962, the new rules will be effective both under subsections (a) and (b). After 1964 the new rules will apply to subsections (a) and (b) of section 902 whether the distributions are from accumulated profits of the foreign corporation and its foreign subsidiary for their taxable years beginning after 1962 or before 1963. The computation involving these rules may be illustrated by the following example involving Corporation P, a domestic corporation which owns 100 percent of the voting stock of foreign Corporation FC which in turn owns 100 percent of the voting stock of foreign subsidiary FS. It is assumed that all transactions have taken place and are related to the taxable year 1963.

Example (3)

(A) Application of amended section 902(b) to determine tax deemed to be paid by Corporation FS:

(i) Gains, profits, and income of Corporation FS	\$100
(ii) Foreign tax paid by Corporation FS with respect to such gains, profits, and income	20
(iii) Accumulated profits in excess of taxes of Corporation FS: \$100 less \$20	80
(iv) Dividends paid by Corporation FS to Corporation FC	40
(v) Corporation FS foreign tax which is deemed paid by Corporation FC: $\$20 \times 40/80$	10

(B) Application of amended section 902(a) to determine tax deemed to be paid by Corporation P:

(i) Gains, profits, and income of Corporation FC:	
Business profits	\$100
Dividends from Corporation FS	40
	140
(ii) Foreign tax paid by Corporation FC with respect to its gains, profits, and income	40
(iii) Accumulated profits in excess of taxes paid by Corporation FC: \$140 less \$40	100
(iv) Dividend paid by Corporation FC to Corporation P	80
(v) Foreign tax paid (\$40) and deemed paid (\$10) by Corporation FC	50
(vi) Foreign taxes paid and deemed paid by Corporation FC which are deemed paid by Corporation P: $\$50 \times 80/100$	40

Where a dividend from a foreign corporation before 1965 is attributable to its accumulated profits for a taxable year beginning after 1962, but which profits are composed in part of a dividend received by such foreign corporation from the accumulated profits of its foreign subsidiary for a taxable year or years of the subsidiary beginning before 1963, for purposes of computing the foreign tax credit a pro rata amount of the dividend received from the foreign corporation will be deemed to consist of accumulated profits of its foreign subsidiary attributable to the period before 1963. Existing law will apply to that portion of the foreign tax paid or accrued or deemed paid by the foreign corporation with respect to such pro rata amount of the dividend considered attributable to the accumulated profits of its subsidiary for taxable years before 1963 and the amendment made by section 11 of this bill will apply to the balance of such tax.

The carryback or carryover of excess foreign taxes allowable under section 904 (d) or (e) will not be affected by this section. An excess foreign tax determined in a year to which the amendments of this section do not apply may be carried over, without adjustment, to a year to which the amendments of this section apply. Conversely, foreign taxes in excess of a section 904(a) limitation in a year to which the amendments of this section apply may be carried back, without adjustment, to a year to which the amendments of this section do not apply.

See the technical explanation accompanying the amendment to section 6038 of the 1954 Code made by section 20(a) of the bill for the effect of the amendments made by section 11 of the bill on the reduction of foreign taxes caused by failure to file an information return under section 6038.

(b) *Inclusion in gross income of amount equal to taxes deemed paid.*—Subsection (b) of section 11 of the bill amends part II of subchapter B of chapter 1 (relating to items specifically included in income) by adding at the end thereof a new section 78. Section 78 requires a domestic corporation to include in gross income as a dividend an amount equal to the taxes deemed, as a result of section 902 (a) or (b) of the code as amended by subsection (a) of section 11 of the bill or as a result of section 957(a) (relating to taxes paid by foreign corporation) as amended by section 13 of the bill, to have been paid by the domestic corporation, if the domestic corporation chooses the benefits of the foreign tax credit. Section 78 only applies where the foreign taxes deemed to have been paid by the domestic corporation are computed under amended section 902, and it is not applicable where the taxes attributable to a particular distribution are computed under present law. Thus, in the preceding example (1) Corporation P will include \$15 in gross income as a dividend. In example (2) Corporation P will include only \$40 in gross income since \$12 of foreign tax deemed to be paid by Corporation P is computed under existing rules. In example (3) Corporation P will include \$40 in gross income.

The amount included in gross income by operation of section 78 is treated as a dividend in the same manner as a dividend actually received by the domestic corporation from a foreign corporation. For example, a section 78 dividend is included in gross income under section 61(a)(7); is personal holding company income for purposes of section 543(a)(1); and may be a portion of accumulated taxable income for purposes of section 535. However, a section 78 dividend is not a dividend for purposes of section 245 of the code (relating to deduction for dividends received from certain foreign corporations).

(c) *Determination of source of dividends received from certain foreign corporations.*—Subsection (c) of section 11 of the bill amends section 861(a)(2)(B) of the code by striking out “to the extent exceeding the amount of the deduction allowable under section 245 in respect of such dividends” and inserting in lieu thereof “to the extent exceeding the amount which is 100/85ths of the amount of the deduction allowable under section 245 in respect of such dividends.” This restores the rule contained in section 119(a)(2)(B) of the 1939 Code, as added by the Revenue Act of 1951. The effect of the change is to establish a closer correlation between the operation of sections 245 and 861(a)(2)(B) than existing law provides.

Under present section 861(a)(2)(B), the excess of the amount of a dividend taken into account in determining the dividends received deduction under section 245 over the amount allowed as a deduction, is determined to be income from sources without the United States for purposes of the foreign tax credit provisions. As a result, 15 percent of that portion of the dividend considered as derived from sources within the United States within the meaning of section 245 is treated as income from sources within the United States for purposes of that section, but, conversely, is treated as income from sources without the United States under section 861(a)(2)(B) for foreign tax credit purposes. Subsection (c) removes this inconsistency by treating as income from sources without the United States for foreign tax credit purposes only the amount of the dividend in excess of one hundred eighty-fifths of the dividends received deduction.

(d) *Repeal of section 902(d).*—Subsection (d) of section 11 of the bill repeals existing section 902(d) (relating to special rules for certain wholly-owned foreign corporations).

(e) *Technical amendments.*—Subsection (e) of section 11 of the bill conforms the table of sections for part II of subchapter B of chapter 1 of the code to the addition of the new section 78 and adds appropriate cross references to sections 901 and 902 of the code. In addition it makes technical changes in section 535(b)(1) and 545(b)(1) to prevent the amendments made by section 11 of the bill from changing “accumulated taxable income” for purposes of the accumulated earnings tax and “undistributed personal holding company income” for purposes of the personal holding company tax and to offset the effects of section 78 whereby these incomes are increased by reason of the taxes deemed to have been paid under section 902 (a) or (b). These technical changes will allow as a deduction the taxes deemed to have been paid under sections 902 (a) and (b).

(f) *Effective date.*—Subsection (f) of section 11 of the bill provides that the amendments made by section 11 are to be applicable to dividends which are received by domestic corporate taxpayers in their taxable years beginning after December 31, 1962, but only to the extent that such distributions are made out of the accumulated profits of foreign corporations for their taxable years beginning after December 31, 1962. However, the amendments made by section 11 of the bill will be applicable to all dividends received by domestic corporate taxpayers from foreign corporations after December 31, 1964, regardless of the year to which the accumulated profits are attributable.

If, before 1965, the distribution from a foreign corporation for its taxable year beginning after December 31, 1962, is out of profits which are attributable to a distribution received by such foreign corporation from its foreign subsidiary, the effectiveness of the amendments depends on the taxable year to which the subsidiary's distribution is attributable. If the distribution is out of the subsidiary's accumulated profits for taxable years beginning after December 31, 1962, the amendments will be applicable. However, if the distribution is attributable to the subsidiary's accumulated profits for taxable years beginning before January 1, 1963, the present law will continue in effect.

The amendments are not applicable to a domestic corporation receiving a distribution from a foreign corporation prior to January 1, 1965, unless such distribution (1) is made out of profit of a foreign corporation accumulated in a taxable year beginning after December 31, 1962, and (2) is received by the domestic corporation in a taxable year beginning after December 31, 1962. Therefore, if for example, a foreign corporation is on a calendar year basis and it makes a distribution on November 15, 1963, out of its accumulated profits for 1963 to a domestic corporation whose taxable year began on December 1, 1962, the present law would be applicable.

SECTION 12. EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES

(a) *Limitation on amount and type of income excluded.*—Subsection (a) of section 12 of the bill amends section 911 of the 1954 code. This amendment retains the provisions of section 911 which require,

under certain circumstances, the exclusion of earned income from gross income of an individual who has been a bona fide resident, or is physically present, in a foreign country. However, under the amendment there will be dollar limitations on the amounts which may be excluded under section 911 by any individual. The amendment also imposes a requirement as to time of receipt and, for some purposes, attributes amounts received to the taxable year in which the services to which the amounts are attributable were performed. The amendment also provides that no amount received as a pension or annuity is excludable under section 911.

SECTION 911. EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES

(a) *General rule.*—Subsection (a) of section 911, as amended by section 12 of the bill, is the same as existing law in that it provides that in the case of an individual citizen of the United States—

(1) who has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, or

(2) who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period,

amounts received from sources without the United States (except amounts paid by the United States or any agency thereof) which constitute earned income attributable to services performed during the uninterrupted period or during an 18-month period, whichever applies, may be excluded from gross income. However, the amended section 911(a) contains a new provision to the effect that the amount excluded under that provision will be computed by applying special rules contained in subsection (c). The new provision referring to the special rules in subsection (c) is in lieu of the unlimited exclusion provided by existing law with respect to bona fide foreign residence, and the \$20,000-limitation with respect to physical presence in a foreign country provided by existing law. Subsection (a) also retains the provision of existing law that no deductions (other than the deductions allowed by section 151, relating to personal exemptions) will be allowed to the extent such deductions are properly allocable to or chargeable against amounts excluded from gross income under such subsection.

(b) *Definition of earned income.*—Subsection (b) of the amended section 911 continues, without change, the existing definition of “earned income”.

(c) *Special rules.*—Subsection (c) of section 911, as amended by the bill, provides rules for purposes of computing the amount excludable from gross income of an individual under section 911(a).

Paragraph (1) of section 911(c) contains the limitations on the amount excludable under section 911(a). It provides, as a general rule, that the amount excluded for any taxable year is not to exceed an amount which is to be computed on a daily basis at an annual rate of \$20,000. However, the annual rate is to be \$35,000 in the case of an individual who qualifies as a bona fide resident of a foreign country or countries under section 911(a)(1), but only with respect to taxable years (or a portion of a taxable year) occurring immediately after

such individual has been a bona fide foreign resident for any uninterrupted period of 3 consecutive years (36 consecutive months). The amount excludable accrues on a daily basis throughout the taxable year. The number of days to be used in making the computation on a daily basis is the number of days in the taxable year for which the exclusion is claimed.

The manner of computing the amount excludable under section 911(a) on a daily basis at the prescribed annual rates may be illustrated by the following example:

Example.—A, a United States citizen, who files his returns on a calendar year basis, is privately employed and is a bona fide resident of France for the period April 1, 1963, through June 30, 1968. The amounts excludable from his gross income for the various calendar years under the provisions of section 911(a) which are computed by applying the special rules contained in section 911(c) are not to exceed the following amounts: for the year 1963, \$15,068.49 ($275/365 \times \$20,000$); for the year 1964, \$20,000 ($366/366 \times \$20,000$); for the year 1965, \$20,000 ($365/365 \times \$20,000$); for the year 1966, \$31,301.37 ($90/365 \times \$20,000$ plus $275/365 \times \$35,000$); for the year 1967, \$35,000; and, for the year 1968, \$17,404.37 ($182/366 \times \$35,000$).

An individual who, on January 1, 1963, has been a bona fide foreign resident for an uninterrupted period in excess of 3 consecutive years is immediately entitled to the benefits of the annual rate of \$35,000. An individual who returns and takes up residence in the United States is, upon resuming bona fide foreign residence, only entitled to the benefits of the annual rate of \$20,000 until such individual completes another uninterrupted period of 3 consecutive years of bona fide foreign residence.

Paragraph (2) of section 911(c) provides that, for purposes of applying the limitation in paragraph (1), amounts received are to be considered received in the taxable year in which the services to which the amounts are attributable are performed. For example, amounts received during the taxable year 1965 attributable to services performed during the taxable year 1964 will, for purposes of applying the limitation in section 911(c)(1), be considered received in the taxable year 1964. Thus, if I (to whom the \$20,000 limitation applies) receives \$16,000 in 1964 and \$7,000 in 1965, both amounts being attributable to his 1964 services, \$3,000 of the \$7,000 received in 1965 would be includible in his gross income for 1965.

Paragraph (3) of section 911(c) provides in effect that in applying the rules of paragraph (1), the amount excludable under section 911(a) is to be neither increased nor decreased solely by operation of community property law.

The application of the rule contained in section 911(c)(3) may be illustrated by the following examples:

Example (1).—H, a United States citizen, qualifies under section 911(a) and receives \$40,000 during a taxable year for services performed abroad during such taxable year. He has been abroad for less than 3 consecutive years. W, the wife of H, earns no income of her own and continues to live in a community property state in the United States. The marital domicile also continues in such state. H and W file a joint return. The aggregate amount excludable from gross income under section 911 is \$20,000. If H and W had filed

separate returns, the aggregate amount excludable under section 911 would be \$20,000.

Example (2).—The facts are the same as in example (1), except that W also resides abroad. Whether H and W file their returns separately or jointly, the aggregate amount excludable under section 911 is \$20,000. If W also qualifies under section 911(a) and receives \$10,000 during the taxable year for services she performed abroad during such taxable year, the aggregate amount excludable under section 911 is \$30,000 (whether a joint return or separate returns are filed).

Similarly, in a noncommunity property jurisdiction, if H and W both qualify under section 911(a) and receive \$40,000 and \$10,000, respectively, for services performed abroad during the taxable year, the aggregate amount excludable under section 911 is \$30,000.

Paragraph (4) of section 911(c) establishes a requirement as to time of receipt by providing that no amount received after the close of the taxable year following the taxable year in which the services to which the amounts are attributable are performed may be excluded under section 911(a). For example, an amount received on or before the close of the taxable year 1965 which is attributable to services performed during the taxable year 1964 will satisfy the requirement as to receipt of section 911(c)(4). However, an amount received after the close of the taxable year 1965 which is attributable to services performed during the taxable year 1964 will not satisfy the requirement as to receipt of section 911(c)(4) and, therefore, will in no event be excludable under section 911(a).

Subparagraph (A) of section 911(c)(5) provides that no amount received as a pension or annuity may be excluded under section 911(a). The result is the same whether the recipient of such pension or annuity is a resident or a nonresident of the United States. Subparagraph (B) provides that no amount included in gross income by reason of section 402(b) (relating to taxability of beneficiary of non-exempt trust), section 403(c) (relating to taxability of beneficiary under a non-qualified annuity), or section 403(d) (relating to taxability of beneficiary under certain forfeitable contracts purchased by exempt organizations) may be excluded under section 911(a). Thus, amounts contributed by an employer to certain plans which do not qualify under section 401 and in which an individual has nonforfeitable rights, must be included in such individual's gross income currently. The amounts of such contributions are not excludable under section 911(a).

SECTION 12. EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES—(Continued)

(f) *Computation of employees' contributions.*—Existing section 72 (f)(2) of the code provides that, in the case of employees' annuities, employees' contributions include amounts contributed by the employer if such amounts would have been exempt from tax had they been paid to the employee directly. Existing law continues to apply to amounts contributed on or before December 31, 1962, for services performed on or before such date.

Subsection (b) of section 12 of the bill amends paragraph (2) of section 72(f) of the code by providing, in general, that such paragraph is not to apply to amounts which were contributed by the employer after December 31, 1962, and which would have been exempt from tax by reason of section 911 had they been paid to the employee directly. However, the preceding sentence does not apply to amounts which were contributed by the employer to provide pension or annuity credits, to the extent such credits are attributable to services performed before January 1, 1963, and are provided pursuant to pension or annuity plan provisions in existence on March 12, 1962, and on that date applicable to such services. Thus, in effect, the first sentence of the amendment contained in section 12(b) of the bill provides that an employee's basis will not be increased by reason of foreign service contributions made by an employer after December 31, 1962, and which would have been exempt from tax by reason of section 911 had they been paid to the employee directly. However, existing law would continue to apply to contributions made after December 31, 1962, to provide benefits attributable to services performed before January 1, 1963, to the extent that (1) such benefits are provided by a plan which is in existence on March 12, 1962, and (2) such contributions are required to provide the benefits set forth in the plan on March 12, 1962. Thus, certain amounts attributable to services performed before January 1, 1963, and contributed after December 31, 1962, to fund current or past service credits may be added to an employee's basis. However, to the extent benefits are initially provided after March 12, 1962, or to the extent existing benefits are increased after such date, amounts attributable to the new or increased benefits may not be added to an employee's basis even though the new or increased benefits are attributable to services performed before January 1, 1963.

(c) *Effective date.*—Subsection (c) of section 12 of the bill contains the effective date provisions applicable to the amendments to sections 911 and 72(f) of the code.

Paragraph (1) of section 12 (c) of the bill provides that, except as provided in paragraph (2), the amendments made by section 12 of the bill are to apply to taxable years ending after December 31, 1962. Paragraph (2) provides that, with respect to the changes in section 911 of the code, the amendment made by section 12(a) of the bill is to apply only with respect to amounts received after December 31, 1962, and which are attributable either, as provided in subparagraph (A), to services performed after such date, or, as provided in subparagraph (B), to services performed on or before such date, but only if on March 12, 1962, there existed no right (whether forfeitable or nonforfeitable) to receive such amounts. Thus, in effect, the effective date provision, with respect to the amendment to section 911, applies existing law to amounts received after December 31, 1962, which are attributable to services performed before January 1, 1963, if on March 12, 1962, a right existed (whether forfeitable or nonforfeitable) to receive such amounts. On the other hand, if amounts are received after December 31, 1962, which are attributable to services performed before January 1, 1963, to which the recipient did not have a right in existence on March 12, 1962, section 911, as amended by section 12 of the bill, will apply to such amounts. In the event a right to receive an amount attributable to services performed before

January 1, 1963 existed as of March 12, 1962, and thereafter such amount is increased, section 911, as amended by section 12 of the bill, will apply to such increase.

The application of the provisions of section 12(c)(2) of the bill may be illustrated by the following examples:

Example (1).—A, a United States citizen, who files his returns on a calendar year basis, is privately employed and a bona fide resident of Italy for the period January 1, 1961, through December 31, 1963. He is compensated at a rate of \$25,000 per year and receives such compensation in the year it is earned. The amounts excludable from gross income for the various calendar years and the applicable provisions of section 911 of the code are as follows: for the years 1961 and 1962, \$25,000 under section 911 before amendment by section 12 of the bill; for the year 1963, \$20,000 under section 911, as amended by the bill.

Example (2).—A, the taxpayer described in example (1), receives on May 1, 1963, \$5,000 as a supplementary salary payment for services performed during the taxable year 1962. Such amount is received pursuant to an agreement in existence on March 12, 1962. Under section 12(c)(2)(B) of the bill, such amount will be subject to section 911 of the code before amendment. The entire supplementary salary payment will be excludable from gross income under section 911(a)(1) (before amendment).

Example (3).—The facts are the same as in example (2), except that no right to receive the \$5,000 supplementary salary payment is in existence on March 12, 1962. Under section 12(c)(2)(B) of the bill, such amount is to be subject to the provisions of section 911, as amended by the bill. Under section 911, as amended, the amount excludable is to be computed under section 911(c). Under section 911(c)(2), the supplementary salary payment is to be considered received in 1962. Under section 911(c)(1), that portion of the amount received which, when added to other qualifying amounts received during the taxable year 1962, does not exceed an amount computed on a daily basis at an annual rate of \$20,000 will be excludable. Since, under the facts set forth in example (1), A received excludable amounts in excess of \$20,000 during the taxable year 1962, no part of the supplementary salary payment is to be excludable from gross income.

SECTION 13. CONTROLLED FOREIGN CORPORATIONS

(a) *Tax on United States shareholders.*—Subsection (a) of section 13 of the bill adds a new subpart F to part III of subchapter N of the Internal Revenue Code of 1954. The new subpart consists of eight sections (secs. 951–958).

SECTION 951. AMOUNTS INCLUDED IN GROSS INCOME OF UNITED STATES PERSONS

(a) *Amounts included.*—Subsection (a) provides that, if a foreign corporation is a controlled foreign corporation on any day of its taxable year, then any United States person who owns stock (within the meaning of section 955(a)) in such corporation, on the last day of such taxable year on which it was a controlled foreign corporation,

must include in gross income for his taxable year (in which or with which ends the taxable year of the controlled foreign corporation) a pro rata share of the corporation's subpart F income and a pro rata share of that portion of the increase in its earnings invested in nonqualified property which is not excluded from gross income under section 956(a). Such shares are included in the income of the United States person, even though there may be intervening entities in a chain between the controlled foreign corporation and such person.

The pro rata share to be included by the United States person (if the corporation is a controlled foreign corporation for its entire taxable year) is that amount which would have been distributed with respect to the ownership interest of such person if the corporation had distributed the total amount of its subpart F income and the total amount of such portion of the increase in its earnings invested in nonqualified property on the last day of its taxable year. If the corporation is a controlled foreign corporation for only part of its taxable year, paragraphs (2) and (3) provide that the pro rata share is that which would have been distributed (on the last day of the corporation's taxable year on which it was a controlled foreign corporation) if the controlled foreign corporation had distributed pro rata an amount which bears to such total amount the same ratio that the part of the year during which the corporation was a controlled foreign corporation bears to the entire taxable year.

Example (1).—X, a United States person, wholly owns throughout 1963 Y, a controlled foreign corporation, which has \$100 of subpart F income and \$100 of earnings and profits for its taxable year 1963. Both X and Y use a calendar year as their taxable year. X, for taxable year 1963, must include \$100 in gross income as if such amount had been distributed on December 31, 1963.

Example (2).—X and T, United States persons with the calendar year as a taxable year, each acquire on July 1, 1963, 30 percent of the voting stock of Y, a foreign corporation (having only one class of stock) which became, as of that day, a controlled foreign corporation. Y has no subpart F income for its taxable year (also the calendar year), has \$100 of earnings and profits for such year, and has a \$100 increase in earnings invested in nonqualified property for its 1963 taxable year. For their 1963 taxable year, X and T each must include in gross income \$15, the amount which would have been distributed with respect to their stock if Y had distributed pro rata $\frac{1}{2}$ of \$100, or \$50 on December 31, 1963.

Subpart F income may not exceed the earnings and profits for the taxable year (computed without reduction for distributions made during that year). The increase in investment in nonqualified property, however, is limited to the sum of the earnings and profits for the taxable year (computed without reduction for distributions made during that year) plus the earnings and profits accumulated for prior taxable years beginning after December 31, 1962. Thus, in examples (1) and (2) it would be irrelevant for purposes of section 951(a) whether Y made an actual distribution during 1963. Such distribution would not, however, because of the rules in section 956, result in further tax to X (in example (1)) or X and T (in example (2)).

An increase in earnings invested in nonqualified property is included in gross income only to the extent that it exceeds the subpart F income for the current taxable year and previous taxable years, but only if

such subpart F income has not already been so used as an offset or has not been actually distributed in a previous taxable year. Distributions from amounts taxed under section 951(a)(1) as increases in earnings invested in nonqualified property and subpart F income are excluded from gross income under section 956. Rules for allocation of distributions to subpart F income, increased earnings invested in nonqualified property, or other earnings and profits are made under the rules of section 956(c).

In a case in which stock of a controlled foreign corporation is transferred by one United States person to another during a taxable year, if the transferor United States person receives a dividend with respect to such stock, the acquiring shareholder, under section 951(a)(2)(B), may reduce the amount he would otherwise be required to include in gross income under section 951(a)(1)(A) by the amount of such dividend. For example, assume that X owns 20 percent of the one class of stock in Z, a controlled foreign corporation, and that on July 1, 1963, immediately after receiving a \$10 dividend, X transfers the stock to Y. X, Y, and Z use the calendar year as the taxable year. Z's entire earnings and profits for 1963 consists of \$100 all of which is subpart F income. X must include in gross income the \$10 dividend. Y must include \$10 (\$20 minus \$10) in his gross income for 1963.

(b) Less than 10 percent ownership.—Subsection (b) limits United States persons subject to tax under subsection (a) to those who own at least 10 percent of the total combined voting power of all classes of stock, or the total value of shares of all classes of stock, of the controlled foreign corporation. The rules of constructive ownership of section 955(b) are applicable for this purpose, although the rules of constructive ownership of section 955(a) are applicable to determine such person's liability under section 951(a).

Example.—H owns 5 percent of the one class of stock of X, a controlled foreign corporation, and his wife, W, owns 10 percent of the stock of such corporation. Under the rules of section 955(b), H is considered to own 15 percent of the stock of X and will be subject to tax on the income attributable to his 5 percent interest.

(c) Coordination with election of a foreign investment company to distribute income.—Subsection (c) provides that a United States person who, for his taxable year, is a qualified shareholder, within the meaning of section 1247(c), of a foreign investment company with respect to which an election under section 1247 is in effect is not required to include in gross income for such year the subpart F income of such company.

SECTION 952. SUBPART F INCOME DEFINED

Section 952 defines the three types of income of a controlled foreign corporation which constitute "subpart F income" and may be includible in the gross income of United States persons, as defined in section 7701(a)(30), under the provisions of section 951(a)(1)(A).

(a) In general.—Paragraph (1) of section 952(a) provides that the subpart F income of a controlled foreign corporation, for purposes of section 951(a)(1)(A), is the sum of (1) the income of the controlled foreign corporation derived from insurance of United States risks, as determined under subsection (b); (2) the income of the controlled

foreign corporation from United States patents, copyrights, and exclusive formulas and processes, as determined under subsection (c); and (3) the net foreign base company income of a controlled foreign corporation as determined under subsection (d). Net foreign base company income of a controlled foreign corporation, however, is included in subpart F income only if five or fewer United States persons own, directly or indirectly, within the meaning of section 955(b), more than 50 percent of the total combined voting power of all classes of stock entitled to vote.

Paragraph (2) provides for the exclusion from subpart F income of a controlled foreign corporation of amounts included in gross income of the controlled foreign corporation under chapter 1 of the code where the controlled foreign corporation is engaged in trade or business in the United States and such income is treated as income from sources within the United States.

Paragraph (3) provides that the subpart F income of a controlled foreign corporation for any taxable year of such corporation may not exceed the earnings and profits of the controlled foreign corporation for that year (computed without reduction for distributions made during the year).

(b) *Income from insurance of United States risks.*—Paragraph (1) of subsection (b) provides, in general, that income derived from the insurance of United States risks is that income which would be taxed under subchapter L of chapter 1 if the controlled foreign corporation were a domestic corporation. However, such income is included in subpart F income only if, in respect of reinsurance or the issuing of insurance or annuity contracts, premiums or other consideration are received either (A) on risks in connection with property in, or residents of, the United States or (B) on risks in connection with property not in, or nonresidents of, the United States in accordance with any arrangement that a substantially equal amount of premiums or other consideration in respect of reinsurance or the issuing of insurance or annuity contracts on risks in connection with property in, or residents of, the United States is to be received by another corporation.

Paragraph (2) of subsection (b) provides special rules which modify the application of subchapter L for purposes of this subsection.

Under subparagraph (A) of paragraph (2), respecting the application of part I of subchapter L, life insurance company taxable income is defined solely as the gain from operations under section 809(b) despite the provisions of section 802(b).

Under subparagraph (B) of paragraph (2), the taxable income of all insurance companies other than life insurance companies, that is, both mutual and stock insurance companies which are ordinarily subject to the provisions of part II or part III of subchapter L, respectively, is to be determined under part III of subchapter L.

Subparagraph (C) of paragraph (2) disallows certain deductions from income for purposes of this subsection. These deductions are:

- (i) Section 809(d)(4) (operations loss deduction),
- (ii) Section 809(d)(5) (certain nonparticipating contracts),
- (iii) Section 809(d)(6) (group life, accident, and health insurance),
- (iv) Section 809(d)(10) (small business deduction),
- (v) Section 817(b) (gain on property held on December 31, 1958, and certain substituted property acquired after 1958), and

(vi) Section 832(b)(5) (certain capital losses).

Under subparagraph (D) of paragraph (2), "gross amount" to the extent prescribed in section 809(c) (1) and (2), less the "increases in certain reserves" as defined in section 809(d)(2), and "premiums earned" as defined in section 832(b)(4), are taken into account only to the extent connected with the United States risks described in section 952(b)(1).

Under subparagraph (E) of section 952(b)(2), all other items of income, that is items other than those taken into account under subparagraph (D), as well as all items of expenses, losses, and deductions shall be apportioned under regulations prescribed by the Secretary of the Treasury or his delegate.

(c) *Income from United States patents, copyrights, and exclusive formulas and processes.*—Paragraph (1) defines the term "income from United States patents, copyrights, and exclusive formulas and processes" as used in section 952(a)(1)(B). Such term means the amount of gross rentals, royalties, or other income derived from the license, sublicense, sale, exchange, use, or other means of exploitation of patents, copyrights, and exclusive formulas and processes which are—

(1) either substantially developed, created, or produced in the United States, or

(2) acquired from (A) a United States person which, directly or indirectly, owns or controls the controlled foreign corporation, (B) a United States person owned or controlled, directly or indirectly, by the controlled foreign corporation, or (C) a United States person which is, directly or indirectly, under common ownership or control with the controlled foreign corporation.

The amount described in the preceding sentence is reduced by the cost and expense allowance defined in section 952(c)(2). Under this definition, if a domestic corporation develops in the United States an exclusive process to be used in the production of a certain product, and a right (whether exclusive or nonexclusive) to use this process is granted to a controlled foreign corporation, the income derived from the use of such process by such controlled foreign corporation would be treated as income derived from a United States exclusive process.

Paragraph (2) permits a controlled foreign corporation to deduct an allowance, in accordance with regulations prescribed by the Secretary of the Treasury or his delegate, for ordinary and necessary expenses incurred by the controlled foreign corporation in the receipt or production of the gross income described in paragraph (1) (including gross income the amount of which is determined under paragraph (3)). The allowance so made includes taxes paid by the controlled foreign corporation with respect to such gross income and an amount necessary to amortize or depreciate the cost to the controlled foreign corporation of the property or rights described in paragraph (1). Thus, if a controlled foreign corporation purchased from a United States person a right developed in the United States for the sum of \$100,000, and if the right was for a period of four years, the controlled foreign corporation would for this purpose be allowed to amortize the \$100,000 cost over the four-year period and deduct such amount from gross income derived from the use of such right.

Paragraph (3) establishes the rule for determining gross rent, royalty, or other income, for purposes of section 952(c), if the controlled foreign corporation uses or exploits a United States patent,

copyright, or exclusive formula or process other than by license, sublicense, sale, or exchange. In such cases, the gross rent, royalty, or other payment is considered to be the amount the controlled foreign corporation would have been required to pay if the property or right had been obtained in an arm's length transaction with an unrelated person. For example, if a controlled foreign corporation received, without cost, from its United States parent a right to use a patent in its operation, section 952(c) requires that a gross royalty be determined. The gross amount so determined by applying the standards of an arm's length transaction, reduced by paragraph (2) expenses, is included in subpart F income.

(d) *Net foreign base company income.*—Subsection (d) defines the term “net foreign base company income” as used in section 952(a)(1)(C). The term is defined to mean (1) the foreign base company income for the taxable year, reduced by (2) the increase in investment in qualified property in less developed countries for the taxable year.

(e) *Foreign base company income.*—Paragraph (1) of subsection (e) defines the term “foreign base company income” as used in section 952(d). The term is defined to mean foreign personal holding company income (as defined in section 553) for the taxable year, with the modifications and adjustments provided in paragraphs (2) through (7) of section 952(e).

Paragraph (2) of section 952(e) provides that foreign base company income includes “foreign base company sales income”, if, for the taxable year, such sales income is equal to at least 20 percent of the gross income of the foreign corporation, not including for this purpose other foreign base company income under section 952(e). The term “foreign base company sales income” is defined to mean income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with the purchase of personal property from a related person and its sale to any person, or the purchase of personal property from any person and its sale to a related person. Such property purchased, however, must have been (A) manufactured, produced, grown, or extracted outside the country under the laws of which the controlled foreign corporation is created or organized, and (B) sold for use, consumption, or disposition outside such foreign country. Thus, the income from the purchase and sale of personal property does not constitute foreign base company sales income if the property purchased is resold for use in the country in which the controlled foreign corporation is created, or the property purchased is an agricultural product, mineral, or manufacture, of the country in which the controlled foreign corporation is created.

Since the definition covers only transactions involving both a purchase and a sale, it does not apply to income of a controlled foreign corporation from the sale of a product which it manufactures. In a case in which a controlled foreign corporation purchases parts or materials which it then transforms or incorporates into a final product, income from the sale of the final product would not be foreign base company sales income if the corporation substantially transforms the parts or materials, so that, in effect, the final product is not the property purchased. Manufacturing and construction activities (and production, processing, or assembling activities which are substantial in

nature) would generally involve substantial transformation of purchased parts or materials.

Commissions received for furnishing services in connection with sales transactions discussed above would also be included in foreign base company sales income.

Since the definition of foreign base company sales income also depends on whether property is sold for use, consumption, or disposition outside the country under the laws of which the controlled foreign corporation is created or organized, a destination test applies. Generally property will be considered to be used, consumed, or disposed of in the country to which it is delivered unless circumstances indicate that the property is to be exported after it is so delivered.

For determining whether a controlled foreign corporation purchases from, or sells to, a related person, a person is a related person as to the controlled foreign corporation if he, directly or indirectly, owns or controls, or is owned or controlled by, or is under common ownership or control with, the controlled foreign corporation.

Paragraph (3) of section 952(e) provides that foreign base company income includes all rents whether or not such rents constitute more than 50 percent of gross income. Section 553 already achieves such a result as to royalties.

Paragraph (4) of section 952(e) provides that foreign base company income does not include income derived from insurance of United States risks (provided for under subsection (b)), or from United States patents, copyrights and exclusive formulas and processes (provided for under subsection (c)).

Paragraph (5) of section 952(e) provides that foreign base company income does not include income of a corporation described in section 552(b), which excepts banks and exempt corporations from the foreign personal holding company provisions, nor does it include income of a foreign corporation 50 percent or more of the fair market value of whose outstanding stock is owned directly or indirectly by a domestic corporation which is either organized under section 25(a) of the Federal Reserve Act, or which has an agreement or an understanding with the Board of Governors of the Federal Reserve System under section 25 of such Act, if all the stock (except qualifying shares) of the domestic corporation is owned by a national or state bank which is a member of the Federal Reserve System.

Paragraph (6) of section 952(e) provides that, if the foreign base company income (before deductions) for the taxable year is less than 20 percent of gross income, no part of the income is to be treated as foreign base company income, but, if foreign base company income (before deductions) for the taxable year exceeds 80 percent of gross income, the entire gross income is to be taken into account in determining foreign base company income.

Paragraph (7) of section 952(e) provides that the foreign base company income for the taxable year shall be reduced so as to take into account deductions (including taxes) properly allocable to such income.

(f) *Investment in qualified property in less developed countries.*— Paragraph (1) of subsection (f) provides the rule for determining the increase in investment in qualified property in less developed countries (this is the amount by which foreign base company income is reduced under subsection (d) to obtain net foreign base company income).

This increase is the amount by which the aggregate amount of certain property held at the close of the taxable year exceeds the aggregate amount of such property held at the close of the preceding taxable year. The property taken into account for this purpose is—

(A) qualified property described in sections 953(b)(2)(C) and (D), and

(B) property (including money) which is located outside the United States and is ordinary and necessary for the active conduct for a qualified trade or business described in section 953(b)(3)(A)(ii).

Paragraph (2) of subsection (f) provides that, under regulations prescribed by the Secretary of the Treasury or his delegate, a controlled foreign corporation may elect to determine the aggregate amount of the property described in paragraph (1) held at the close of the taxable year and at the close of the preceding taxable year as of the close of the 75th day after the close of each taxable year.

Paragraph (3) of subsection (f) provides that the amount taken into account under subsection (f)(1) with respect to any property is to be its adjusted basis, reduced by any liability to which the property is subject.

SECTION 953. INVESTMENT OF EARNINGS IN NONQUALIFIED PROPERTY

Section 953 establishes rules for determining the extent to which a controlled foreign corporation's increase in earnings is invested in nonqualified property and thus includible, under the provisions of section 951(a)(1)(B), pro rata in gross income of United States persons. Subsection (a) establishes rules for determining a United States persons pro rata share of a controlled foreign corporation's "increase in earnings invested in nonqualified property". Subsection (b) defines the term "nonqualified property".

(a) *General rules.*—Paragraph (1) of section 953(a) provides that the amount of earnings of a controlled foreign corporation invested in nonqualified property at the end of any taxable year is the aggregate amount of such property held at the close of the taxable year, but not in excess of the sum of the earnings and profits for the taxable year and the earnings and profits accumulated for prior taxable years beginning after December 31, 1962.

Paragraph (2) of section 953(a) provides that the increase for any taxable year of a United States person's pro rata share of the earnings of a controlled foreign corporation invested in nonqualified property is the amount determined by subtracting, from his pro rata share of the amount determined under paragraph (1) for the close of the taxable year, his pro rata share of the amount determined under paragraph (1) for the close of the preceding taxable year, reduced by amounts paid during the taxable year to which section 956(c)(1) applies.

Paragraph (3) of section 953(a) provides that the amount taken into account under paragraphs (1) or (2) with respect to any property is to be its adjusted basis, reduced by any liability to which the property is subject.

(b) *Nonqualified property defined.*—Paragraph (1) of subsection 953(b) provides the general rule that the term "nonqualified property"

means any money or other property, tangible or intangible, which is not "qualified property" (as defined in paragraph (2) of section 953(b)). However, all property acquired by a controlled foreign corporation before January 1, 1963, is treated as if it were qualified property, whether or not it comes within the definition of paragraph (2).

Paragraph (2) of section 953(b) defines the term "qualified property". Thus, any property of a controlled foreign corporation which does not qualify under one of the four categories listed in paragraph (2), with the exception of property acquired before January 1, 1963, is considered to be nonqualified property for purposes of the new subpart F.

Subparagraph (A) of section 953(b)(2) includes within the definition of "qualified property" money or other property which is ordinary and necessary for the active conduct of a "qualified trade or business" of the controlled foreign corporation, provided the money or other property is located outside the United States.

Subparagraph (B) of section 953(b)(2) provides that property which would qualify under subparagraph (A) except for the fact that it is located in the United States is still to be treated as qualified property if it is referred to in clause (i), (ii), or (iii) of subparagraph (B). Clause (i) refers to obligations of the United States, money, or deposits with persons carrying on the banking business. Clause (ii) refers to property purchased in the United States for export to, or for use in, foreign countries. Clause (iii) refers to any loan arising in connection with the sale of property, if the amount of such loan outstanding at no time during the taxable year exceeds the amount which would be ordinary and necessary to carry on the trade or business of both the lending corporation and the borrowing United States person had the sale been made between unrelated persons.

Subparagraph (C) of new section 953(b)(2) defines "qualified property" to include certain stock investments in certain foreign corporations. Under this provision, stock owned by a controlled foreign corporation is considered qualified property if the criteria set forth in subparagraph (C) are satisfied. First, the foreign corporation whose stock is owned must be created or organized under the laws of a less developed country, as defined in section 953(b)(5). Second, such foreign corporation must be engaged in the active conduct of a trade or business in the country in which it was created or organized. Third, substantially all of the property of such foreign corporation must be ordinary and necessary for the active conduct of its trade or business, and such business must be engaged in almost wholly within less developed countries. Fourth, more than 50 percent of the total combined voting power of all classes of stock entitled to vote must be owned, directly or indirectly, by the controlled foreign corporation and four or fewer United States persons; except that if the laws under which such foreign corporation is created or organized limit the amount of voting stock which is permitted to be owned, such lesser percentage of ownership as is permitted must be owned, directly or indirectly, by the controlled foreign corporation and four or fewer United States persons. Fifth, the controlled foreign corporation must own at least 10 percent of the voting stock and 10 percent of the value of all classes of stock of such foreign corporation.

Subparagraph (D) of section 953(b)(2) includes within the definition of "qualified property" investments required because of restrictions imposed by the laws of a less developed country, as defined in section 953(b)(5). In addition, investments made at a time when restrictions imposed by the laws of a less developed country required that the investment be made may be held as qualified property, even though such restrictions have been removed, if withdrawal of the investment would result in substantial losses to the controlled foreign corporation.

Paragraph (3) of subsection 953(b) defines the term "qualified trade or business," used in section 953(b)(2)(A). As defined, a trade or business of a controlled foreign corporation is a qualified trade or business if such trade or business, or substantially the same trade or business, is carried on by the controlled foreign corporation outside the United States and has been so carried on by such corporation, while controlled by substantially the same United States persons either (1) since December 31, 1962, or (2) during the 5-year period ending with the close of the preceding taxable year of the controlled foreign corporation. In determining whether or not a trade or business is the same or substantially the same trade or business during the applicable period, all the facts and circumstances of the particular case must be taken into consideration. The test is intended to prevent the use of earnings which have not been subjected to U.S. tax to diversify the business of the controlled foreign corporation, while permitting the controlled foreign corporation to compete in the lines of activity it is presently engaged in. In this regard, circumstances which may be particularly important involve the nature of the product line of the controlled foreign corporation and the character of the principal foreign competitors of the controlled foreign corporation in that line.

In addition, a trade or business carried on by a controlled foreign corporation will constitute a qualified trade or business if it is carried on almost wholly within a less developed country.

For purposes of paragraph (3), even where there have been changes in the ownership of U.S. persons, a controlled foreign corporation may be considered controlled by substantially the same United States persons if more than 50 percent of the voting power of all classes of stock entitled to vote was owned, directly or indirectly, by either the same United States persons or other United States persons whose relationship indicates that there has been no substantial change in interest. For example, stock transferred to the estate or heirs of a deceased owner by reason of his death, or stock transferred by a domestic corporation to a 100-percent-owned domestic subsidiary, may be considered for purposes of subparagraph (3) to have been held by substantially the same United States persons.

Subparagraph (B) of section 953(b)(3) treats an investment of a controlled foreign corporation as having been made in a qualified trade or business of the controlled foreign corporation if the amount of the investment is made in the stock of a second foreign corporation in which the controlled foreign corporation has owned at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total value of all classes of stock continuously since December 31, 1962, or if the controlled foreign corporation owned such amount of stock continuously during

the entire 5-year period ending with the close of the controlled foreign corporation's preceding taxable year. In this situation the second controlled foreign corporation receiving the amount invested by the first controlled foreign corporation must use the amount received in the conduct of a trade or business which would qualify under subparagraph (A) as if it were conducted by the first controlled foreign corporation.

Paragraph (4) of section 953(b) provides that obligations of United States persons held by controlled foreign corporations are considered property located in the United States, as are pledges or guarantees made with respect to obligations of United States persons.

Paragraph (5) of section 953(b) defines the term "less developed country." Except for certain countries and areas specified in the paragraph which may not be designated as less developed countries, the designation of which countries are less developed is left to Executive order.

SECTION 954. CONTROLLED FOREIGN CORPORATIONS

(a) *Controlled foreign corporations defined.*—Subsection (a) defines "controlled foreign corporations," for purposes of the new subpart F, to mean a foreign corporation of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned by United States persons on any day during the taxable year of the corporation. In this connection, constructive rules of ownership provided in section 955(b) apply.

(b) *Special rule for insurance.*—Subsection (b) provides a special definition of controlled foreign corporations solely for the purpose of including the income derived from insurance of United States risks, referred to in section 952(a)(1)(A), in the gross income of a United States person. Under the special definition "controlled foreign corporation" includes not only a foreign corporation satisfying subsection (a) but also one of which more than 25 percent of the total combined voting power of all classes of stock is owned by United States persons, on any day during the taxable year of a corporation, if the gross amount of premiums or other consideration in respect of any reinsurance or issuing of insurance or annuity contracts in connection with property in the United States, or residents of the United States, exceeds 75 percent of the gross amount of all premiums or other consideration in respect of all risks. Only the subpart F income consisting of income from insurance of United States risks is required to be included in the gross income of a United States person owning stock in a corporation satisfying subsection (b) but not subsection (a).

(c) *Special rule for certain less developed countries.*—Subsection (c) also provides a special definition for those controlled foreign corporations, created or organized under the laws of a less developed country, stock in which is "qualified property" under section 953(b)(2)(C). The special rule provides that the maximum percentage of ownership (if 50 percent or less) permitted under the laws of a less developed country is considered, in lieu of the more than 50 percent requirement in subsection (a), the percentage required under subsection (a) in order for the corporation to be classified as a controlled foreign corporation.

SECTION 955. RULES FOR DETERMINING STOCK OWNERSHIP

Section 955 provides, in subsection (a), a limited rule of stock ownership for determining the amount taxable to a United States person, and, in subsection (b), a broader set of constructive rules of ownership for determining whether the requisite ownership by United States persons exists so as to make a corporation a controlled foreign corporation or a United States person has the requisite ownership to be liable for tax under section 951(a).

(a) *For purposes of section 951(a).*—Subsection (a) provides that for purposes of determining the amount of the income of a corporation which is taxable to a United States person under section 951(a), a United States person owns the stock which he owns directly in a foreign corporation and also that which he owns through certain foreign entities as follows: stock owned, directly or indirectly, by or for a foreign corporation, foreign partnership, or a foreign trust or foreign estate (within the meaning of section 7701(a)(31)) is considered as proportionately owned by the shareholders, partners, or beneficiaries. Stock owned by such a foreign entity with the application of such rule is considered as actually owned by such foreign entity for again applying the rule. The rule in effect gives rise to a chain of ownership and, since the rule operates only on stock owned by a foreign entity, attribution under the rule stops with the first United States person in the chain of ownership running from the controlled foreign corporation to such person. For example, W, a domestic corporation, owns 80 percent of the class of stock of X, a foreign corporation, which in turn owns 80 percent of the class of stock of Y, another foreign corporation, which in turn owns 90 percent of the only class of stock in Z. Under the rule, X is considered as owning 80 percent of the 90 percent which Y owns in Z, or 72 percent. 80 percent of such 72 percent, or 57.6 percent of the stock in Z, is considered as owned by W. Since W is a domestic corporation which is a United States person, W is the person taxed even though W is wholly owned by U, another domestic corporation. If Z has \$100 of subpart F income, then W is required to include \$57.60 in gross income under section 951(a).

Paragraph (3) of subsection (a) provides, for the sole purpose of taxing United States persons on a foreign mutual insurance company's income derived from insurance of United States risks, that the term "stock" includes any certificate entitling the holder to voting power in the corporation.

(b) *Other provisions.*—Subsection (b) provides constructive rules of ownership based, with certain specified exceptions, on section 318. The principle to be followed in applying such rules is that they are to be applied so that the effect is to subject a United States person to the requirement of section 951(a), to treat 5 or fewer U.S. persons as owning more than 50 percent of all classes of stock entitled to vote for purposes of requiring a controlled foreign corporation to include net foreign base company income in its subpart F income, or to make a corporation a controlled foreign corporation under section 954.

The specified exceptions to the rules of section 318 are as follows:

- (1) No attribution of ownership from a nonresident alien individual (other than a foreign estate or trust) to a citizen or

resident of the United States can occur under section 318(a)(1)(A);

(2) In considering stock owned by a partnership, estate, trust, or corporation, as owned by the partners, beneficiaries, or shareholders—

(A) a partnership, estate, trust, or corporation which owns more than 50 percent of the total combined voting power of all classes of stock entitled to vote, is to be considered as owning all the voting power of all such classes of stock;

(B) a partnership, estate, trust, or corporation which owns more than 50 percent of the total value of shares of all classes of stock of a corporation is to be considered as owning the total value of all classes of stock;

(3) Stock of a partner, beneficiary, or shareholder which is attributed to the partnership, estate, trust, or corporation will not be attributed out to another partner, beneficiary, or shareholder; and

(4) The requirement that a corporate shareholder own more than 50 percent of the stock of a corporation before ownership of such stock can be attributed to the shareholders of such corporate shareholder is not to apply.

Example (1).—M, N, and O, all United States persons, each own 20 percent of the stock in X, a foreign corporation having only one class of stock, which in turn owns 60 percent of the stock in Y, also a foreign corporation having only one class of stock. For the purpose of attributing the stock owned by X in Y to M, N, and O, X is considered as owning all of the stock of Y with the result that M, N, and O are considered as each owning 20 percent of the stock of Y.

Example (2).—X, an owner of 50 percent of the one class of stock in Y, owns 8 percent of the one class of stock in Z, a controlled foreign corporation; W, the owner of the other 50 percent of the stock in Y owns 45 percent of the one class of stock of Z. X is considered as owning no part of the stock in Z which is owned by W. Thus, X does not own 10 percent or more of the stock of Z so as to be required under section 951(a) to include in gross income any amount of income of Z.

SECTION 956. EXCLUSION FROM GROSS INCOME OF PREVIOUSLY TAXED EARNINGS AND PROFITS

(a) *Exclusion from gross income of United States persons.*—Subsection (a) provides that earnings and profits of a foreign corporation attributable to amounts once included in gross income under section 951(a) are not again included in gross income when actually distributed. The exclusion is applicable whether the income included in gross income under section 951 was required to be included by reason of direct ownership of stock in a controlled foreign corporation or ownership through a chain of ownership described in section 955(a). Further, the exclusion applies with respect to the United States person who owned stock in a foreign corporation at the time it was included in gross income under section 951(a), or with respect to a successor in interest who can at the time of the actual distribution provide such proof as the Secretary of the Treasury or his delegate by regulations require that he holds the interest of the United States person who

previously included in gross income the earnings and profits being distributed.

Example.—On December 31, 1963, X, a United States person, owns 20 shares of the 100 shares of the only class of stock in Z, a controlled foreign corporation, and by reason of such ownership includes \$20 in gross income under section 951 (his proportionate share of Z's \$100 of subpart F income which constituted Z's entire earnings and profits for its 1963 taxable year). On January 31, 1964, X transfers 9 shares of his stock in Z to Y. On June 1, 1964, X receives an \$11, and Y a \$9, distribution from Z. Neither the \$11 received by X nor the \$9 received by Y is includible in gross income.

Subsection (a) in conjunction with section 951(a)(1)(B) also prevents including in gross income under section 951(a)(1)(B) any increase in earnings invested in nonqualified property to the extent such increase can be considered as attributable to subpart F income taxable under section 951(a)(1)(A). Subpart F income thus provides an offset to prevent the inclusion in gross income of amounts otherwise includible as an increase in earnings invested in nonqualified property. For example, Z, a controlled foreign corporation wholly owned by X, a domestic corporation, has \$40 subpart F income, and a \$50 increase in earnings invested in nonqualified property; X includes in gross income only \$10 of the \$50 because \$40 of such \$50 is offset by the \$40 of subpart F income included in X's gross income.

(b) *Exclusion from gross income of certain foreign subsidiaries.*—Subsection (b) provides that, for purposes of section 951(a), income of a controlled foreign corporation once included in gross income of a United States person is not, when distributed to another controlled foreign corporation, included in any of such other foreign corporation's income which must be taxed to such United States person or his successor in interest. For example, X, a domestic corporation, wholly owns Y, a controlled foreign corporation which in turn wholly owns Z, another controlled foreign corporation. In 1970, Y has no income except that which is received from Z, which has \$100 of income which X is required to include in gross income under section 951. Such \$100, although paid to Y as a dividend in 1970, is not included in the income of Y which must be included in the gross income of X, even though such a dividend would ordinarily constitute subpart F income. The same result follows whether the dividend is paid in 1970 or a later year so long as under the rules of subsection (c) it is allocated to earnings and profits under paragraphs (1) and (2) which were once included in X's gross income under section 951.

(c) *Allocation of distributions.*—Subsection (c) provides rules for the allocation of distributions to earnings and profits. Amounts included in gross income of a shareholder under section 951(a) do not constitute distributions for purposes of reducing the earnings and profits of the controlled foreign corporation. Accordingly, when the controlled foreign corporation makes an actual distribution, thereby reducing its earnings and profits, it is necessary at the shareholder level to identify whether the distribution is from earnings and profits attributable to amounts already included in gross income of the shareholder under section 951(a) (in which case the distribution is not taxable as a dividend) or is from earnings and profits which are attributable to amounts not so taxed (in which case the distribution is taxable as a dividend). Under subsection (c), earnings and profits

attributable to amounts once taxed (described in paragraphs (1) and (2)) are to be considered to be distributed until they are exhausted (first from the current year and next from past years). Subsequent distributions, after the earnings and profits described in paragraphs (1) and (2) have been received by a shareholder, are taxable as dividends to the extent of the remaining earnings and profits.

A shareholder is not taxable on a distribution which is out of earnings and profits described in paragraph (1) (relating to earnings invested in nonqualified property) or paragraph (2) (relating to subpart F income). The separate classification of earnings and profits under paragraphs (1) and (2) is for purposes of computing a United States person's pro rata share of the increase in earnings in nonqualified property under section 953. For purposes of section 953(a)(2)(A), the amount of earnings invested in nonqualified property for a taxable year is reduced by earnings so invested which were actually distributed. For this purpose, paragraph (1) of section 956(c) provides that earnings and profits attributable to investment in nonqualified property are the first earnings and profits considered as distributed to a shareholder.

In this connection, although amounts taxed once under section 951(a)(1)(A) as subpart F income may offset amounts representing an increase in earnings in nonqualified property under section 951(a)(1)(B) (so as to avoid taxing the same earnings twice) such offset does not affect the amount of earnings and profits attributable to amounts representing the increase in earnings in nonqualified property for purposes of paragraph (1). The amount of earnings and profits under paragraph (1) includes earnings and profits attributable to amounts includible in gross income under section 951(a)(1)(B) as well as earnings and profits attributable to amounts which would have been included under such section except for the availability of the offset by reason of the inclusion of amounts under section 951(a)(1)(A) as subpart F income. Earnings and profits attributable to amounts included in subpart F income, but used to offset an increase in earnings invested in nonqualified property are not, however, included in paragraph (2) since they are already included in paragraph (1). Thus, there is no duplication in the amounts attributable to paragraphs (1) and (2), and, from the standpoint of the shareholder, the amount of earnings and profits allocable to him under paragraphs (1) and (2) is always equal to the amount of income he has been taxable on under section 951(a) (and for which he has not received an actual distribution).

(d) *Distributions excluded from gross income not to be treated as dividends.*—Except for deeming foreign taxes paid by foreign corporations as being paid by a domestic corporation in special cases discussed below, a distribution excluded from gross income under section 956 is treated as a distribution which is not a dividend.

SECTION 957. SPECIAL RULES FOR FOREIGN TAX CREDIT

A domestic corporation owning stock in a controlled foreign corporation is required to include in its gross income, under the provisions of subpart F, income of such foreign corporation, whether or not the foreign corporation is one or more links removed in a chain of ownership. Therefore, section 902 (relating to credit for corporate stock-

holder in foreign corporation) which depends on actual distributions would not operate to give the domestic corporation a credit for foreign taxes paid by the controlled foreign corporation. Section 957 provides rules, consistent with section 902, for treating foreign taxes paid by controlled foreign corporations on income which is included in the gross income of domestic corporations under section 951(a) as having been paid by such domestic corporations.

(a) *Taxes paid by a foreign corporation.*—Subsection (a) applies to a domestic corporation which includes in gross income under section 951(a) an amount attributable to earnings and profits of a foreign corporation at least 10 percent of the voting stock of which is directly owned by such domestic corporation, or of a foreign corporation at least 50 percent of the voting stock of which is owned by a foreign corporation at least 10 percent of the voting stock of which in turn is directly owned by the domestic corporation. Such a domestic corporation is deemed to have paid the same proportion of the total income, war profits, and excess profits taxes paid by the controlled foreign corporation to a foreign country or possession of the United States for its taxable year which the amount of the earnings and profits of the foreign corporation included in gross income of the domestic corporation bears to the entire earnings and profits of such foreign corporation for such taxable year.

Example (1).—X, a domestic corporation, wholly owns Y, a foreign corporation, which in turn wholly owns Z, another foreign corporation. X, Y, and Z each use the calendar year as a taxable year. For 1963, X is deemed to have paid taxes actually paid by Y and Z as follows:

	X	Y	Z
Earnings and profits.....		60	80
Foreign taxes.....		40	20
Subpart F income.....		30	50
Gross income under sec. 951 (30+50).....	80.00		
Foreign taxes deemed paid by X under sec. 957(a) and included in gross income under sec. 78:			
$\left(\frac{30}{60} \times 40\right)$	20.00		
$\left(\frac{50}{80} \times 20\right)$	12.50		

If a domestic corporation receives a distribution any part of which is excluded from gross income under section 956, the foreign taxes which are deemed to have been paid under section 957(a) are not again deemed paid under section 902. Other foreign taxes which are not deemed paid under section 957 because paid, for instance, by a first-tier corporation, through which profits of a second-tier corporation are distributed (after having been taxed under section 951 to a United States corporation), will still be deemed paid under section 902 when an actual distribution is made. A distribution of such profits, although excluded under section 956(a), is treated by the domestic corporation as a dividend solely for taking into account under section 902 such foreign taxes as were not deemed paid under section 957.

Example (2).—Suppose that the \$50 of subpart F income of Z taxed to X in 1963 in the example above was in 1970 distributed to Y who received no other income for such year, and that Y paid a tax of \$20 for 1970 and distributed the remaining \$30 to X before the end of 1970.

In such case, although such \$30 is excluded from gross income under section 956(a), it is treated as a dividend under section 902 so that for 1970, X is deemed to have paid \$20 in foreign taxes.

Under paragraph (4) of section 957(a), if income of a first-tier foreign corporation required to be included in the gross income of a domestic corporation under section 951(a) includes a dividend from a second-tier foreign corporation to the first-tier corporation, then such amount included in gross income of the domestic corporation under section 951 is considered as a dividend so that foreign taxes paid by the second-tier corporation and not already allowed as a credit may be deemed paid by the first-tier foreign corporation under section 902(b), and, in turn, then deemed paid by the domestic corporation under section 957(a).

Example (3).—M, a domestic corporation, wholly owns N, a controlled foreign corporation, which in turn wholly owns O, also a controlled foreign corporation but which has no income required to be included in any United States person's gross income. For taxable year 1970, O paid \$40 in foreign taxes. O pays to N as a dividend its total earnings and profits of \$60 for such taxable year, which dividend is N's only income and which in N's hands is foreign base company income required to be included in M's gross income under section 951(a). N has no deductions and pays no foreign taxes. The \$60 required to be included in M's gross income is considered a dividend for purposes of applying section 902(b) with the result that N is deemed to have paid \$40 in foreign taxes and M is in turn deemed to have paid \$40 under section 957(a).

(b) *Special rules for foreign tax credit on receipt of previously taxed earnings and profits.*—Where a United States person receives a distribution which is excluded from income under section 956(a) because it was once taxed as income included in gross income of a United States person under section 951(a), the section 904 limitation is increased in the year of actual distribution so that a credit will be allowed for foreign taxes imposed on the income distributed after it was included in gross income under section 951. The United States person, however, must have either chosen the foreign tax credit in the taxable year in which such income was included in gross income under section 951(a), or else have paid or accrued in such year no income, war profits, or excess profits taxes to any foreign country or possession of the United States. He must also choose the foreign tax credit in the year of the receipt of the excluded distribution.

The amount of the increase in the section 904 limitation is an amount equal to the increase in such limitation which occurred in the taxable year of the inclusion of the income¹ under section 951(a) solely by reason of such inclusion. Such amount is then reduced by the foreign taxes which were allowed as a credit in such year of the inclusion but which would not have been allowable but for such inclusion. The increase in the section 904 limitation may not exceed the income, war profits, or excess profits taxes paid, or deemed paid, or accrued with respect to the distribution in the taxable year such distribution is received.

Under paragraph (3) of section 957(b), a taxpayer who chose to take a foreign tax credit in the taxable year in which he was required to include income in gross income under section 951(a), but does not choose to take a foreign tax credit in the taxable year in which such

income is actually received, may not deduct under section 164 any income, war profits, or excess profits taxes paid or accrued on such income.

Under paragraph (4) of section 957(b), if the increase in limitation exceeds the U.S. tax for the taxable year, the excess is deemed an overpayment of tax for such year.

SECTION 958. ADJUSTMENTS TO BASIS OF STOCK IN CONTROLLED FOREIGN CORPORATION AND OTHER PROPERTY

To prevent doubling up of tax where stock in a controlled foreign corporation is sold at a gain which reflects the retained earnings already taxed to United States persons, the basis of stock would be adjusted.

(a) *Increase in basis.*—Subsection (a) provides that the basis of a United States person's stock in a controlled foreign corporation, and of property by reason of which he is treated as owning such stock in determining the amount which he must include in gross income under section 951, is increased by the amount included in gross income under section 951.

Example (1).—X, who owns stock in Y with a basis of \$1,000, includes \$50 of Y's income in gross income as required under section 951. The basis of X's stock in Y is increased to \$1,050.

Example (2).—The facts are the same as in example (1) except that X is also required under section 951 to include in gross income \$60 of the income of Z, a controlled foreign corporation wholly owned by Y. In such case the basis of X's stock in Y is increased to \$1,110.

(b) *Reduction in basis.*—The basis of stock or other property with respect to which a United States person receives an amount which is excluded from gross income under section 956(a) is reduced by such amount. Thus, if X, in the last example above, received a distribution of \$110 which was excluded from gross income under section 956(a) as the income previously taxed in such example, the basis of X's stock in Y would be reduced again to \$1,000.

To the extent that an amount excluded from gross income under section 956 (a) exceeds the adjusted basis of stock or other property with respect to which it is received, it is treated as gain from the sale or exchange of the property.

(b) *Technical and clerical amendments.*—Paragraph (1) of this subsection amends section 551(b) (relating to foreign personal holding company income included in gross income of United States shareholders) to provide that the amount of undistributed foreign personal holding company income otherwise required to be included under section 551(b) in gross income of a United States person is reduced by his proportionate share of undistributed foreign personal holding company income included in gross income under section 951(a) for the taxable year as his proportionate share of subpart F income of such controlled foreign corporation.

Paragraphs (2), (3), (4), (5) and (6) make conforming changes.

(c) *Effective date.*—Subsection (c) provides that the amendments made by section 13 are to apply with respect to taxable years of foreign corporations beginning after December 31, 1962, and the taxable years of United States persons in which or with which such taxable years of such corporations end.

SECTION 14. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE PROPERTY

(a) *In general.*—Paragraph (1) of section 14(a) of the bill adds a new section 1245 to the 1954 Code. In general, the new section provides for the inclusion in gross income (as ordinary income) of the gain from the disposition of certain depreciable property, to the extent of depreciation deductions taken in taxable years beginning after December 31, 1961, which are reflected in the adjusted basis of such property.

SECTION 1245. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE PROPERTY

(a) *General rule.*—Paragraph (1) of section 1245(a) provides the general rule that if “section 1245 property” is disposed of after the date of the enactment of the Revenue Act of 1962, the amount by which the lower of “recomputed basis” or the amount realized (or the fair market value in transactions in which no amount is realized) exceeds the adjusted basis of the property is to be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. The term “disposed of” includes any transfer or involuntary conversion.

Paragraph (2) of section 1245(a) defines recomputed basis as the adjusted basis of the property recomputed by adding thereto all adjustments, for taxable years beginning after December 31, 1961, reflected in such adjusted basis on account of deductions for depreciation, or for amortization under section 168, whether in respect of the same or other property and whether allowed or allowable to the taxpayer or any other person. For example, if a taxpayer purchases section 1245 property on January 1, 1963, at a cost of \$10,000 and the taxpayer takes depreciation deductions of \$2,000 (the amount allowable) before making a gift of the property to his son, the son's adjusted basis in the property for purposes of determining gain would, under the provisions of sections 1015 (relating to the basis of property acquired by gift) and 1016 (relating to adjustments to basis), be the same as his father's adjusted basis (\$8,000), and the recomputed basis of the property in the son's hands would be \$10,000 since the \$2,000 of depreciation deductions taken by the father are reflected in the son's basis in the property. Thus, if the son later sells the property for \$10,000, he would have \$2,000 of gain to which section 1245(a) applies. Moreover, if the son himself takes \$1,000 in depreciation deductions (the amount allowable) with respect to the property and then sells it for \$10,000, he would have \$3,000 of gain to which section 1245(a) applies.

While recomputed basis is determined with respect to adjustments to basis for deductions for depreciation (and for amortization under sec. 168) which were either allowed or allowable, if the taxpayer can establish by adequate records or other sufficient evidence that the amount allowed for any taxable year was less than the amount allowable, the amount to be added for such taxable year is the amount allowed. For example, assume that in the year 1967 it becomes necessary to determine the recomputed basis of property, the adjusted basis of which reflects an adjustment of \$1,000 with respect to deprecia-

tion deductions allowable for the year 1963. If the taxpayer can establish by adequate records or other sufficient evidence that he had been allowed a deduction of only \$800 for 1963, then in determining the recomputed basis, the amount added to adjusted basis with respect to the \$1,000 adjustment to basis for 1963 will be only \$800.

Paragraph (1) of section 1245(a) further provides that gain is to be recognized notwithstanding any other provision of subtitle A of the 1954 Code. Thus, other nonrecognition sections of the code are overridden by the new section. For example, the gain under such paragraph (1) would be recognized to a corporation in the case of a distribution of section 1245 property by it to a shareholder, notwithstanding the provisions of section 311(a) or 336. Likewise, gain under such paragraph (1) would be recognized to a corporation on a sale or exchange of such property, notwithstanding the provisions of section 337. The operation of section 1245 may, however, be affected by the taxpayer's method of accounting. For example, the gain from a disposition to which section 1245 applies may be reported by the taxpayer under the installment method if such method is otherwise available under section 453 of the code.

In the case of a disposition of section 1245 property in which an amount is realized (a sale, exchange, or involuntary conversion), the gain to which section 1245(a) applies is the amount by which the amount realized or the recomputed basis, whichever is lower, exceeds the adjusted basis of the property. In the case of any other disposition, the gain to which section 1245(a) applies is the amount by which the fair market value of the property on the date of disposition or its recomputed basis, whichever is lower, exceeds its adjusted basis. For example, if section 1245 property has an adjusted basis of \$2,000 and a recomputed basis of \$3,300 and is sold for \$2,900, the gain to which section 1245(a) applies is \$900 (\$2,900 minus \$2,000). If the property is sold for \$3,700, the gain is \$1,700, of which \$1,300 (\$3,300 minus \$2,000) is gain to which section 1245(a) applies. If, on the other hand, the property is distributed by a corporation to a stockholder in a distribution to which section 1245(a) applies and at a time when the fair market value of the property is \$3,100, the gain recognized to the corporation upon such disposition is \$1,100 (\$3,100 minus \$2,000); if the fair market value is \$3,800 at the time of such disposition, the gain to which section 1245(a) applies is \$1,300 (\$3,300 minus \$2,000).

Paragraph (3) of section 1245(a) defines "section 1245 property." Section 1245 property is any property (other than livestock) of a type described in subparagraph (A) or (B) of such paragraph (3) which is or has been property of a character subject to the allowance for depreciation provided in section 167. Even though the property may not be subject to the allowance for depreciation in the hands of the taxpayer, such property is nevertheless subject to the provisions of section 1245(a) if the property was subject to the allowance for depreciation in the hands of any prior holder, and if such depreciation is taken into account in determining the adjusted basis of the property in the hands of the taxpayer.

The definition of section 1245 property is similar in certain respects to the definition of "section 38 property" contained in section 48(a) (relating to the investment credit). However, section 1245 property is a broader concept than section 38 property, since (for example)

the definition of section 1245 property is not subject to the minimum useful life provision in section 48(a)(1) or to the other limitation and exclusion provisions in paragraphs (2) through (5) of section 48(a). Moreover, the term "personal property" in subparagraph (A) of section 1245(a)(3) is intended to include not only "tangible personal property" as defined in section 48(a)(1)(A) but also intangible personal property.

Subparagraph (B) of section 1245(a)(3) describes other property (not including a building or its structural components) if such other property is tangible and has an adjusted basis in which there are reflected adjustments for depreciation or amortization under section 168 which would be taken into account in determining recomputed basis for a period in which such property (or other property) either (i) was used as an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or (ii) constituted research or storage facilities used in connection with any such activities. The language in clauses (i) and (ii) in section 1245(a)(3)(B) is intended to have the same meaning as when used in clauses (i) and (ii) in section 48(a)(1)(B) (relating to the definition of sec. 38 property subject to the investment credit). Even though the property is not used by the taxpayer as an integral part of an activity specified in clause (i), or does not constitute research or storage facilities within the meaning of clause (ii), such property in certain circumstances may, nevertheless, be section 1245 property under subparagraph (B). An illustration of such a circumstance is when the adjusted basis of such property in the hands of the taxpayer reflects adjustments for depreciation with respect to such property taken for taxable years beginning after December 31, 1961, at a time when such property was used as an integral part of manufacturing by the taxpayer or another taxpayer. Another illustration is when the adjusted basis of such property in the hands of the taxpayer reflects adjustments for depreciation with respect to *other* property (as, for example, in the case of a like kind exchange under sec. 1031) taken for taxable years beginning after December 31, 1961, at a time when such other property was used as an integral part of manufacturing by the taxpayer.

(b) *Exceptions and limitations.*—Subsection (b) of section 1245 sets forth certain exceptions and limitations to the general rule provided in subsection (a). Paragraph (1) provides that subsection (a) will not apply to a disposition by gift. Paragraph (2) provides that, except as provided in section 691, subsection (a) will not apply to a transfer at death.

Paragraph (3) of section 1245(b) provides that if the basis of property in the hands of a transferee is determined by reference to its basis in the hands of the transferor by reason of the application of certain sections of the code providing for nonrecognition treatment, then the amount of gain taken into account by the transferor under subsection (a)(1) is to be limited to the amount of gain recognized by the transferor under these sections (determined without regard to sec. 1245). These nonrecognition provisions are: Section 332 (relating to distributions in liquidation of an 80 percent or more controlled subsidiary corporation); section 351 (relating to transfers to a corporation controlled by the transferor); section 361 (relating to exchanges pursuant

to certain corporate reorganizations); section 371(a) (relating to exchanges pursuant to certain receivership and bankruptcy proceedings); section 374(a) (relating to exchanges pursuant to certain railroad reorganizations); section 721 (relating to transfers to a partnership in exchange for a partnership interest); and section 731 (relating to distributions by a partnership to a partner). For example, assume that a taxpayer transfers section 1245 property to a corporation in exchange for cash of \$1,000, and stock in the corporation worth \$9,000, in a transaction qualifying under section 351. The property has a fair market value of \$10,000, a recomputed basis of \$8,000, and an adjusted basis of \$4,000. Since under section 351(b) gain in the amount of \$1,000 would be recognized to the transferor without regard to the new section 1245, subsection (b)(3) limits the gain taken into account by the transferor under section 1245(a) to \$1,000. The basis of the property in the hands of the corporation under section 362(a) (relating to basis to corporations of property acquired by issuance of stock, etc.) will be \$5,000, that is, the adjusted basis of the property in the hands of the transferor (\$4,000) increased by the gain recognized to the transferor on the transfer (\$1,000). If the corporation later sells the property for \$10,000 without taking any deductions with respect to the property, the gain recognized to the corporation under subsection (a) will be \$3,000, the excess of recomputed basis (\$8,000) over adjusted basis (\$5,000).

Since the limitation provided in subsection (b)(3) upon the gain recognized under subsection (a) is confined to instances of "carryover basis," in the case of the liquidation of an 80 percent or more controlled subsidiary the limitation is not applicable if the basis of the property in the hands of the parent corporation is determined under section 334(b)(2). Subsection (b)(3) does not apply to a disposition of property to an organization (other than a cooperative described in sec. 521) exempt from taxation under chapter 1 of the code, but no implication is intended as to whether a transfer to such an exempt organization could or could not qualify for nonrecognition under the sections of the code set forth in subsection (b)(3).

Paragraph (4) of section 1245(b) provides that if property is disposed of and gain (determined without regard to sec. 1245) is not recognized in whole or in part under section 1031 (relating to like kind exchanges) or 1033 (relating to involuntary conversions), then the amount of gain taken into account under section 1245(a) is not to exceed the sum of the amount of gain recognized on such disposition (determined without regard to sec. 1245) plus the fair market value of property acquired which is not section 1245 property and which is not otherwise taken into account in determining the gain under section 1031 or 1033. For example, assume that a taxpayer owns section 1245 property with an adjusted basis of \$100,000 and a recomputed basis of \$116,000. The property is destroyed by fire and the taxpayer receives \$117,000 of insurance proceeds. He uses \$105,000 of the proceeds to purchase property similar or related in service or use to the property destroyed in an acquisition qualifying under section 1033(a)(3)(A), and he uses \$9,000 of the proceeds to purchase stock in the acquisition of control of a corporation owning property similar or related in service or use to the converted property, which acquisition also qualifies under section 1033(a)(3)(A). The taxpayer properly elects under section 1033(a)(3)(A) and the regulations thereunder to limit recognition of

gain to the amount by which the amount realized from the conversion exceeds the cost of the stock and other property acquired to replace the converted property. Since \$3,000 of the gain is recognized (without regard to sec. 1245) under section 1033(a)(3) (that is, \$117,000 minus \$114,000), and since the stock purchased for \$9,000 is not depreciable property and was not taken into account in determining the gain under section 1033, the amount of gain to be taken into account under section 1245(a) may not exceed \$12,000. Thus, section 1245(a) applies to \$12,000 of the \$16,000 gain.

Paragraph (5) of section 1245(b) empowers the Secretary of the Treasury or his delegate to prescribe regulations setting forth rules consistent with paragraphs (3) and (4) in the case of transactions described in section 1071 (relating to gain from sale or exchange to effectuate policies of FCC) or section 1081 (relating to nonrecognition of gain or loss on exchanges or distributions in obedience to orders of SEC).

Paragraph (6)(A) provides that, for purposes of section 1245, the basis of section 1245 property distributed by a partnership to a partner will be deemed to be determined by reference to the adjusted basis of such property to the partnership. Paragraph (6)(B) provides that, for purposes of computing the recomputed basis of such property, the amount of the adjustments added back for periods before the distribution is the amount of gain to which section 1245(a) would have applied if such property had been sold by the partnership immediately before the distribution, reduced by the amount of such gain which resulted from the application of section 751(b). Thus, since the basis of section 1245 property distributed by a partnership to a partner is deemed to be a carryover basis, any subsequent disposition of the property which requires a computation of the recomputed basis would have to take into account adjustments to basis for depreciation deductions taken before the distribution. However, such adjustments are fixed at an amount equal to the gain to which section 1245(a) would have applied if the partnership had sold the property instead of distributing it, assuming no gain upon distribution arose out of the application of section 751(b).

The application of this provision is illustrated as follows: A, B, and C are equal partners in a partnership whose assets consist of three pieces of section 1245 property, assets X, Y, and Z, each with a fair market value of \$100,000. Asset X has an adjusted basis of \$60,000 and a recomputed basis of \$85,000; asset Y has an adjusted basis of \$85,000 and a recomputed basis of \$110,000; and asset Z has an adjusted basis of \$95,000 and a recomputed basis of \$100,000. Asset Y is distributed to B in complete liquidation of his partnership interest. B's basis in his partnership interest is \$75,000 and under section 732 this basis is allocated to asset Y. If B later sells asset Y for \$103,000 at a time when the adjusted basis is still \$75,000 and if B has not taken any depreciation deductions with respect to asset Y since the distribution, the gain to which section 1245(a) applies would be \$15,000, since the recomputed basis of the property is only \$90,000, that is, the adjusted basis of the property (\$75,000) increased by the amount of gain (\$15,000) which would have been recognized to the partnership if the asset had been sold for its fair market value at the time of distribution (\$100,000 minus \$85,000).

(c) *Adjustments to basis.*—Subsection (c) of section 1245 provides that the Secretary of the Treasury or his delegate is to prescribe such regulations as he may deem necessary to provide for adjustments to the basis of property to reflect gain to which section 1245(a) applies. This provision is necessary to prevent the same amount from being subjected to taxation more than once. For example, under existing law if a corporation distributes section 1245 property to a corporate shareholder, generally the amount of the distribution and the basis of the property in the hands of the corporate distributee is the fair market value of the property or its adjusted basis in the hands of the distributing corporation, whichever is lower. Under section 1245, however, the distribution may result in gain being recognized to the distributing corporation and unless the distributee is permitted to increase its carryover basis by the amount of the gain recognized to the distributor, the same gain may be subjected to tax when the distributee later sells the property. Therefore, under regulations prescribed by the Secretary of the Treasury or his delegate, adjustment will be made to the basis of the distributed property to reflect the gain recognized to the distributing corporation.

(d) *Application of section.*—Subsection (d) of section 1245 provides that the section is to apply notwithstanding any other provision of subtitle A of the code. Thus, section 1245 overrides any nonrecognition provision of subtitle A or any “income characterizing” provision. For example, the gain to which section 1245(a) applies might otherwise be considered as gain from the sale or exchange of a capital asset under section 1231 (relating to property used in the trade or business and involuntary conversions). Since section 1245 overrides section 1231, the gain to which section 1245(a) applies will be treated as ordinary income, and only the remaining gain, if any, from the property may be considered as gain from the sale or exchange of a capital asset if section 1231 is applicable. For example, assume that a taxpayer sells for \$130 section 1245 property with an adjusted basis of \$40 and a recomputed basis of \$100. The excess of the recomputed basis over adjusted basis, or \$60, will be treated as gain under section 1245(a). The excess of the selling price over recomputed basis, or \$30, may be considered under section 1231 as gain from the sale of a capital asset.

Subsection (d) is not intended to prevent gain not recognized under section 1245 from being considered as gain under another provision of the code. For example, assume that a taxpayer purchases section 1245 property for \$1,000 and for taxable years beginning on or before December 31, 1961, he takes deductions of \$500 under section 168 (relating to amortization of emergency facilities). Assume that if section 168 had not applied the taxpayer would instead have taken depreciation deductions of \$300. For taxable years beginning after December 31, 1961, the taxpayer takes additional deductions under section 168 of \$400. Under these facts, if the property is then sold for \$800, section 1245(a) would recognize gain to the extent of the \$400 in deductions taken in taxable years beginning after December 31, 1961, but would not recognize gain to the extent of the deductions taken in prior taxable years. Nothing in subsection (d) prevents \$200 of the remaining gain from being taxed under section 1238 (relating to amortization in excess of depreciation).

SECTION 14. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE PROPERTY—(Continued)

(b) *Change in method of depreciation.*—Subsection (b) of section 14 of the bill amends subsection (e) of section 167 of the 1954 Code (relating to depreciation). Paragraph (1) of section 167(e) is the same in substance as existing section 167(e). Paragraph (2), which is new, permits any taxpayer within such period after the date of the enactment of the Revenue Act of 1962 and in such manner as the Secretary of the Treasury or his delegate shall by regulations prescribe, to elect to change his method of depreciation in respect of section 1245 property from any declining balance or sum of the years-digits method to the straight-line method.

(c) *Salvage value of personal property.*—Subsection (c)(1) of section 14 of the bill adds a new subsection (f) to section 167 of the code (relating to depreciation) and redesignates subsections (f), (g), and (h) of section 167 as subsections (g), (h), and (i), respectively.

Paragraph (1) of section 167(f) provides the general rule that, under regulations prescribed by the Secretary of the Treasury or his delegate, a taxpayer may, for purposes of computing the allowance for depreciation with respect to personal property, reduce the amount taken into account as salvage value by an amount which does not exceed 10 percent of the basis of such property (as determined under sec. 167(g) as of the time as of which such salvage value is required to be determined). For example, a taxpayer purchases depreciable personal property on January 1, 1963, for \$10,000. The estimated useful life of the property is 10 years and the estimated salvage value is \$500. The taxpayer uses the straight-line method of depreciation. Under present law the taxpayer would take depreciation deductions of \$950 in each of the 10 years of the useful life of the property. However, under section 167(f) the taxpayer may reduce salvage value, for purposes of computing the allowable depreciation deduction, by 10 percent of \$10,000. Since this amount, \$1,000, is greater than the estimated salvage value, \$500, the salvage value may be reduced to zero and the taxpayer may deduct \$1,000 in each year of the useful life of the property. In the above case, if the taxpayer had taken into account salvage value of only \$700 but the estimated salvage value had actually been \$1,500, the Internal Revenue Service could not adjust the amount used by the taxpayer since the reduction of salvage value by 8 percent of basis would be within the privilege granted by the new section 167(f).

Paragraph (2) of section 167(f) defines "personal property" as depreciable personal property (other than livestock) with a useful life of 3 years or more acquired after the date of the enactment of the Revenue Act of 1962.

(d) *Special rule for charitable contributions of section 1245 property.*—Subsection (d) of section 14 of the bill adds a new subsection (e) to section 170 of the code (relating to deductions for charitable contributions). Under the new subsection, the amount of a charitable contribution of section 1245 property will be reduced by the amount which would have been treated as gain to which section 1245(a) applied if the property had been sold at its fair market value instead of contributed to the charity. For example, a taxpayer owns depreciable property with an adjusted basis of \$10,000, a recomputed

basis of \$14,000, and a fair market value of \$17,000. If the property were sold for \$17,000, gain of \$4,000 under section 1245(a) would result. Assume that the taxpayer contributes the property to a qualifying charitable organization. Under the new section 170(e) the amount of the charitable contribution would be \$13,000 (\$17,000 minus \$4,000).

(e) *Technical amendments.*—Paragraph (1) of section 14(e) of the bill amends section 751(c) of the code to provide that, for purposes of section 751 (relating to unrealized receivables and inventory items), section 731 (relating to extent of gain or loss on distribution), section 736 (relating to payments to a retiring partner or a deceased partner's successor in interest), and section 741 (relating to recognition and character of gain or loss on sale or exchange), the term "unrealized receivables" will include section 1245 property, but only to the extent of the amount which would be treated as gain to which section 1245(a) applied if the property were sold by the partnership at its fair market value. Thus, the rules provided in section 751 with respect to unrealized receivables will also apply with respect to section 1245 property, to the extent of the potential section 1245(a) gain. For example, if a partner sold his interest in a partnership to a third party, the portion of the amount realized on such sale allocable to the partner's share of the potential section 1245(a) gain on the section 1245 property of the partnership will be recognized to the partner.

Paragraph (2) of section 14(e) of the bill amends section 301 (b) and (d) of the code (relating to the amount distributed and basis in a corporate distribution of property) by striking out "subsection (b) or (c) of section 311" and inserting in lieu thereof "subsection (b) or (c) of section 311 or under section 1245(a)."

Paragraph (3) of section 14(e) of the bill amends section 312(c)(3) (relating to adjustments to earnings and profits) by striking out "subsection (b) or (c) of section 311" and inserting in lieu thereof "subsection (b) or (c) of section 311 or under section 1245(a)."

Paragraph (4) of section 14(e) of the bill adds a new paragraph (12) to section 341(e) (relating to collapsible corporations). New paragraph (12) provides that, for purposes of section 341(e), the determination of whether gain from the sale or exchange of property would be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231(b) is to be made without regard to the application of section 1245(a).

Paragraph (5)(A) of section 14(e) of the bill adds a new sentence at the end of section 453(d)(4)(A), relating to distribution of installment obligations in complete liquidations of subsidiaries under section 332. Section 453(d)(4)(A) provides that if an installment obligation is distributed by one corporation to another corporation and if under section 332 no gain or loss is recognized to the recipient corporation with respect to the receipt of such obligation, then no gain or loss with respect to the distribution of such obligation is recognized to the distributing corporation. The new sentence provides that if section 334(b)(2) (relating to the basis of property received in certain liquidations to which sec. 332 applies) applies in respect of property received by the distributee corporation, then the rule of existing law is not to apply to the extent that under paragraph (1) of section 453(d) gain to the distributing corporation would be

considered as gain to which section 1245(a) applies. For example, assume that corporation X sells section 1245 property and returns its income therefrom on the installment method under section 453. Corporation Y then buys all the outstanding stock of X and within 2 years after the purchase X adopts a plan of complete liquidation. If an installment obligation received by X upon the sale of the section 1245 property is distributed to Y in the liquidation, gain will be recognized to X under paragraph (1) of section 453(d) to the extent that the excess of the fair market value of the obligation over its basis constitutes gain to which section 1245(a) applies.

Paragraph (5)(B) of section 14(e) of the bill adds a new sentence at the end of section 453(d)(4)(B), relating to distribution of installment obligations in liquidations to which section 337 applies. Section 453(d)(4)(B) provides that if an installment obligation is distributed by a corporation in the course of a liquidation and if under section 337 no gain or loss would have been recognized to the corporation if the corporation had sold or exchanged such obligation on the day of the distribution, then no gain or loss is recognized to the corporation by reason of the distribution. The new sentence provides that the preceding rule is not to apply to the extent that under paragraph (1) of section 453(d) gain to the distributing corporation would be considered as gain to which section 1245(a) applies. For example, assume that corporation X, which makes its return on the basis of the fiscal year ending June 30, adopts a plan of complete liquidation on March 15. On June 15, X sells section 1245 property and returns its income therefrom on the installment method under section 453. On October 15, X distributes all of its property (including an installment obligation received in respect of the sale) in complete liquidation. Gain will be recognized to X under paragraph (1) of section 453(d) to the extent that the excess of the fair market value of the installment obligation over its basis constitutes gain to which section 1245(a) applies.

(f) *Effective date.*—Subsection (f) of section 14 of the bill provides that the amendments made by section 14 shall apply to taxable years beginning after December 31, 1961, and ending after the date of the enactment of the bill.

SECTION 15. FOREIGN INVESTMENT COMPANIES

(a) *Treatment of sale of stock of foreign investment companies.*—Subsection (a)(1) of section 15 of the bill adds to part IV of subchapter P of chapter 1 of the code (relating to special rules for determining capital gains and losses) two new sections, section 1246 (relating to gain on foreign investment company stock) and section 1247 (relating to election by foreign investment companies to distribute income currently).

Section 1246 provides for the inclusion as ordinary income of certain gains from the sale or exchange of stock in a foreign investment company. However, section 1246 will not apply if, under section 1247, the foreign investment company elects to fulfill the requirements of such section and such shareholders include in computing their long-term capital gains, their share of the company's net long-term capital gains over the net short-term capital losses, whether or not distributed.

SECTION 1246. GAIN ON FOREIGN INVESTMENT COMPANY STOCK

(a) *Treatment of gain as ordinary income.*—Under subsection (a)(1) of section 1246, any gain from the sale or exchange after December 31, 1962, of stock to which the subsection applies is to be treated as gain from the sale or exchange of property which is not a capital asset, but only to the extent of the taxpayer's ratable share of the earnings and profits of the company accumulated for taxable years beginning after December 31, 1962. Any additional gain or any loss on the sale or exchange of such stock will remain unaffected by these provisions. Subsection (a)(1) applies to stock in a foreign corporation which was a foreign investment company at any time during the period during which the taxpayer held such stock. Thus subsection (a)(1) applies whether or not the foreign corporation is within the definition of a foreign investment company at the time of the sale or exchange. However, since under section 15(c) of the bill, section 1246 applies only with respect to taxable years beginning after December 31, 1962, the corporation must have been a foreign investment company while the taxpayer held the stock at some time during such a taxable year.

Subsection (a)(2) of the new section 1246 provides that the taxpayer's ratable share of the accumulated earnings and profits is to be determined under regulations prescribed by the Secretary of the Treasury or his delegate. Such determination is to include only the taxpayer's ratable share of the earnings and profits of the foreign corporation accumulated for the period during which the taxpayer held stock in such foreign corporation (excluding any portion of such period occurring in a taxable year of the corporation beginning before January 1, 1963). Such determination will exclude the taxpayer's share of undistributed earnings and profits which previously had been taxed to him under section 951 (relating to amounts included in gross income of United States persons, added by sec. 13 of the bill) or under section 551 (relating to foreign personal holding company income taxed to United States shareholders). The amount of the accumulated earnings and profits for any period is determined after applying the rules of the code that distributions are treated as made out of the most recently accumulated earnings and profits.

Subsection (a)(3) of the new section 1246 requires the taxpayer to establish the amount of the accumulated earnings and profits of the foreign corporation and his ratable share of such amount. He must establish this information for the period during which he held such stock, including whatever holding period is required by other subsections of section 1246. Failure to establish this information will result in all the gain from the sale or exchange of such stock being considered as gain from the sale or exchange of property which is not a capital asset.

Subsection (a)(4) of the new section 1246 provides that section 1246 is not to apply where the holding period of the stock as of the date of the sale or exchange is 6 months or less.

(b) *Definition of foreign investment company.*—Under subsection (b) of section 1246 a foreign investment company is defined as a foreign corporation which meets one of two tests. The first test is met if the foreign corporation is registered under the Investment Company Act of 1940, as amended (15 U.S.C. 80a-1 to 80b-2), either as a management company or as a unit investment trust. Under the Investment Company Act of 1940, an investment company organized or created under the laws of a foreign country is required to register with the Securities and Exchange Commission in order to make a public offering of its securities in the United States. The Act defines an investment company, in general, as any issuer of securities which is or holds itself out as being engaged primarily in the business of investing, reinvesting, or trading in securities. Under the second test provided by the new section 1246(b), a foreign corporation, even though it does not make a public offering of its securities and does not register under the Act, is a foreign investment company if it comes within the definition of an investment company described above at a time when more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock, was held directly or indirectly (within the meaning of sec. 955(a) of the code, added by sec. 13 of the bill), by United States persons (as defined in sec. 7701(a)(30) of the code, added by sec. 9(h) of the bill). Under the Investment Company Act of 1940, the term “security” is defined broadly and includes among others, stock, Treasury stock, bond, debenture, any evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, certificate of deposit for a security, or a fractional undivided interest in oil, gas, or other mineral rights.

(c) *Stock having transferred or substituted basis.*—Subsection (c) of new section 1246 provides that stock in a foreign corporation, the basis of which (in the hands of the taxpayer selling or exchanging such stock) is determined by reference to the basis (in such taxpayer's hands or any other person's hands) of stock in a foreign investment company, will to the extent provided in regulations prescribed by the Secretary of the Treasury or his delegate be treated as stock of a foreign investment company. The stock which is so treated will be considered under section 1223 (relating to holding period of property) to be held by the taxpayer throughout the period during which the foreign investment company stock was held in addition to the period during which the stock in the foreign corporation is held. Transactions to which subsection (c) applies include the following:

A person owning stock in a foreign investment company transfers such stock to foreign corporation F which he controls in exchange for stock of Corporation F in a transaction to which section 351 applies. Clearance under section 367 is obtained. The stock of Corporation F received in exchange for the foreign investment company stock will be considered stock of a foreign investment company. If the stock of Corporation F is later transferred by gift, the donee will

also treat such stock as stock of the foreign investment company and the holding period of the donee will include the period during which the donor held the stock in the foreign investment company and Corporation F.

(d) *Rules relating to entities holding foreign investment stock.*—Subsection (d) of the new section 1246 provides that to the extent provided in regulations prescribed by the Secretary of the Treasury or his delegate, trust certificates of a trust to which section 677 (relating to income for benefit of grantor) applies, or stock in a domestic corporation, will be treated as stock of a foreign investment company to the extent that such trust or corporation has an investment in stock in a foreign investment company. As a result of this provision the taxpayer is deemed to be holding stock of the foreign investment company. The trust certificates or stock are to be treated under section 1223 as held by the taxpayer throughout the holding period for which the trust or domestic corporation held stock in a foreign investment company, but limited to the period during which the taxpayer held such trust certificates or stock in the domestic corporation. Such stock is deemed to be held by him in the same proportion that the actual investment in stock in a foreign investment company by the trust or domestic corporation bears to the total assets of such trust or domestic corporation. For example, if a domestic corporation has an investment of \$20,000 in stock of a foreign investment company and total assets of \$100,000, the proportion of the domestic corporation's investment is 20 percent. Therefore 20 percent of each share of stock in such corporation will be deemed to be foreign investment stock and 20 percent of the gain, if any, resulting from the sale or exchange thereof will be subjected to section 1246 treatment.

(e) *Rules relating to stock acquired from a decedent.*—Paragraph (1) of subsection (e) sets forth the manner for computing the basis of stock in a foreign investment company which is acquired from a decedent dying after December 31, 1962, and treats the holding period by the heir or successor in the manner provided for in subsection (c). Under paragraph (1) of subsection (e) the stock's basis determined under section 1014 will be reduced by the decedent's ratable share of the company's earnings and profits accumulated in taxable years beginning after December 31, 1962. For example, if the stock had an adjusted basis of \$100, a fair market value of \$150 on the date of the decedent's death, and \$30 was the decedent's ratable share of the accumulated earnings and profits during the period he held such stock after December 31, 1962, the person acquiring the stock from the decedent would have a basis of \$120 (\$150—\$30). In no case is the basis determined under section 1014 to be reduced below the adjusted basis of the stock in the hands of the decedent immediately before his death, regardless of the decedent's ratable share of such earnings. Thus, in the above example, the basis could not be reduced below \$100.

The stock so acquired from a decedent shall be treated as if it were held throughout the holding period of the decedent in addition to the holding period of the person acquiring the stock. Thus, in effect the holding period of the decedent is tacked onto that of the person acquiring the stock. If, in the example illustrated in the preceding paragraph, the stock were sold immediately after acquisition at its

fair market value of \$150, the gain of \$30 (\$150—\$120) would be treated as gain from the sale of property which is not a capital asset. If, after acquisition the stock further increased in value, upon a sale or exchange, \$30 plus the portion of the gain which is equal to the taxpayer's ratable share of the accumulated earnings and profits of the corporation for the period during which he held such stock would be treated in the same manner.

In the event the decedent's executor decides to determine the gross estate under section 2032 (relating to alternate valuation), for purposes of section 1246(e), the date the stock is so valued will be considered the date of the decedent's death. Therefore, the basis determined at such later date will be reduced by the decedent's ratable share of the earnings and profits accumulated during the period preceding the date of his death and the earnings and profits accumulated during the period between such date and the date of alternate valuation.

Paragraph (2) of section 1246(e) provides that if foreign investment company stock acquired from a decedent is sold or exchanged at a gain which gain is subject to ordinary income treatment under subsection (a) of section 1246, the taxpayer, under regulations prescribed by the Secretary of the Treasury or his delegate, is to be allowed a deduction from gross income, for the taxable year of the sale or exchange, equal to that portion of the decedent's estate tax deemed paid which is attributable to the excess of (A) the value at which such stock was taken into account for purposes of determining the value of the decedent's gross estate, over (B) the value at which it would have been so taken into account if such value had been reduced by the amount representing the reduction in basis described in paragraph (1). The value determined in (B) is actually the taxpayer's basis of the stock as determined under section 1246(e)(1). The provision of paragraph (1) may be illustrated by the following example:

Example.

The gross estate of a decedent dying in 1963 was \$125,000, which included foreign investment company stock valued at \$5,000. Assuming deductions of \$10,000 and an exemption of \$60,000, the taxable estate amounted to \$55,000. The estate tax paid on this amount is \$8,250. Assuming that the decedent's share of earnings and profits accumulated after December 31, 1962, was \$500 the heir's basis for such stock determined under section 1246(e)(1) would be \$4,500. If the heir sold such stock in 1963, he is allowed to deduct the following amount from his 1963 gross income:

Estate tax actually paid (on taxable estate of \$55,000)	\$8, 250
Less: Estate tax computed by reducing the gross estate by \$500 (tax on taxable estate of \$54,500)	8, 125

Amount deducted from the heir's gross income..... 125

If in 1963, the heir had sold only one-half of the stock, then only \$62.50 ($\frac{1}{2}$ of \$125) could have been deducted from his gross income.

(f) *Information with respect to certain foreign investment.*—Subsection (f) of section 1246 requires certain United States shareholders of a foreign investment company to furnish with respect to such company such information as the Secretary of the Treasury or his delegate shall by regulations prescribe. The requirement is applicable only to those United States persons who on the last day of the taxable year of a

foreign investment company beginning after December 31, 1962, own 5 percent or more in value of the stock of such company.

(g) *Cross reference.*—Subsection (g) of section 1246 is a cross reference to section 312(l) of the code (relating to effect on earnings and profits of foreign investment companies) which is added by section 15(b)(1) of the bill.

SEC. 1247. ELECTION BY FOREIGN INVESTMENT COMPANIES TO DISTRIBUTE
INCOME CURRENTLY

Section 1247 provides that section 1246 will not apply to the shareholders of a registered foreign investment company if such company makes the election provided for by section 1247, and if the shareholders include in their income their proportionate share of the company's long-term capital gain.

(a) *Election by foreign investment company.*—Section 1247(a)(1) provides that if a foreign investment company of the type defined in section 1246(b)(1) (relating to registered foreign investment companies) makes the election provided by section 1247, section 1246 will not apply with respect to its qualified shareholders during any taxable year of the company to which the election is effective. Such election must be made on or before December 31, 1962, in the manner provided in regulations prescribed by the Secretary of the Treasury or his delegate. The election commits the company to fulfill the requirements provided in subparagraphs (A), (B), and (C) of subsection (a)(1) for each taxable year beginning after December 31, 1962.

Under subparagraph (A), the company elects to distribute to its shareholders at least 90 percent of its taxable income. For this purpose, taxable income is the amount determined as if such company were a domestic corporation but with the adjustments provided in subparagraph (A) of paragraph (2).

Under subparagraph (B), the company elects to designate, in a written notice mailed to its shareholders at any time before 30 days after the close of its taxable year, the pro rata amount of any excess of net long-term capital gains over net short-term capital losses and the portion thereof which is being distributed. Such determinations are to be made as if such company were a domestic corporation.

Under subparagraph (C), the company elects to provide such information as the Secretary of the Treasury or his delegate deems necessary to carry out the purposes of section 1247.

Paragraph (2)(A) of subsection (a) provides special rules for computing taxable income under paragraph (1)(A).

Subparagraph (A) states that such taxable income will be determined without regard to—

(i) the excess of the net long-term capital gains over net short-term capital losses for the taxable year,

(ii) the net operating loss deduction under section 172, and

(iii) the deductions provided in part VIII of subchapter B (relating to special deductions for corporations), other than the deduction provided in section 248 (relating to organizational expenses).

Paragraph (2)(B) provides that in determining the amount of the distribution made under paragraph (1)(A), a distribution made after the close of the taxable year but on or before the 15th day of the third

month of the next taxable year will be considered as distributed during the earlier year to the extent elected by the company on or before the 15th day of such third month. Such election is to be made in accordance with regulations prescribed by the Secretary of the Treasury or his delegate.

Subparagraph (C) of paragraph (2) provides that for purposes of making the computations under paragraph (1)(B), any capital loss under section 1212 incurred prior to the first effective year of the election will not be carried forward to the period for which the election is effective.

(b) *Years to which election applies.*—Subsection (b) of the new section 1247 provides that the election is to terminate as of the close of the taxable year preceding its first taxable year in which—

(1) the company fails (unless it is shown that such failure is due to reasonable cause and not due to willful neglect) at any time to comply with any of the requirements set forth in subsection (a)(1),

(2) the company is a foreign personal holding company, or

(3) the company is not a registered foreign investment company as described in section 1246(b)(1).

(c) *Qualified shareholders.*—Paragraph (1) of subsection (c) of section 1247 defines a “qualified shareholder” to mean a shareholder who is a United States person (as defined in sec. 7701(a)(30), added by sec. 9(h) of the bill) other than a shareholder described in paragraph (2) of subsection (a) of section 1247.

Paragraph (2) provides that a United States person is not to be treated as a qualified shareholder for the taxable year if for such taxable year (or for any prior taxable year) he fails to include (in computing his long-term capital gains in his return for such taxable year) the amount designated by the company as his share of the company’s undistributed capital gains for its taxable year ending within or with the shareholder’s taxable year. Once a taxpayer fails to comply with the provisions of this paragraph in determining his status as a qualified shareholder, he loses the benefits of a qualified shareholder for the duration of the election and section 1246 will apply when he sells or exchanges the stock of the foreign investment company at a gain. However, if a taxpayer can show that the failure to include his share of the undistributed capital gains in his return was due to reasonable cause and not due to willful neglect, he will continue to be treated as a qualified shareholder.

(d) *Adjustments.*—Subsection (d) of the new section 1247 provides that when undistributed capital gains are included in the qualified shareholder’s gross income, adjustments must be made (1) in the earnings and profits of the electing foreign investment company, and (2) to the adjusted basis of his stock to reflect the inclusion in his gross income of such gains. Such adjustments are to be made in accordance with regulations prescribed by the Secretary of the Treasury or his delegate.

(e) *Loss on sale or exchange of certain stock held less than 6 months.*—If a share of stock is held by a qualified shareholder for less than 6 months and if he treats any amount designated under section 1247(a)(1)(B) as long-term capital gain with respect to such shares, then subsection (e) of section 1247 requires any loss on the sale or exchange of such share (to the extent of the amount so treated as long-term capital gain) to be treated as loss from the sale or exchange of a capital

asset held for more than 6 months. For example, on December 20, 1963, A purchases a share of stock in Corporation F, an electing foreign investment company, for \$50. Corporation F (which is on a calendar year basis) designates A's share of its long-term capital gains for the year 1963 as being \$5. No distribution with respect to capital gains is made. A, therefore, includes \$5 in computing his long-term capital gains in his return for 1963. On January 10, 1964, A sells such share for \$49. Since A has a basis of \$55 (the \$50 original cost plus the \$5 capital gain included in income but not distributed) the sale results in a loss of \$6. Subsection (e) treats \$5 of this loss as a long-term capital loss.

SECTION 15. FOREIGN INVESTMENT COMPANIES

(Continued)

(b) *Conforming amendments.*—Paragraph (1) of section 15(b) of the bill amends section 312 of the 1954 Code (relating to effect on earnings and profits) by adding after subsection (k) thereof a new subsection (l).

Paragraph (1) of subsection (l) provides that upon the sale or exchange of stock in a foreign investment company by a shareholder who is a United States person, if such foreign investment company is a member of an affiliated group (as defined in par. (2)), then the accumulated earnings and profits of all member companies are to be allocated under regulations prescribed by the Secretary of the Treasury or his delegate, in such a manner as to carry out the purposes of section 1246.

Paragraph (2) of subsection (l) defines the term “affiliated group” for purposes of subsection (l)(1) to have the same meaning as such term has in section 1504(a) except that (A) “more than 50 percent” is substituted for “80 percent or more” wherever appearing in section 1504(a), and (B) all corporations are treated as includible corporations without regard to section 1504(b).

Paragraph (3) of new subsection (l) provides a rule governing the reduction in the earnings and profits of a foreign investment company as a result of amounts distributed by a foreign investment company in a partial liquidation or in redemptions to which section 302(a) or 303 applies. The portion of the distribution which is chargeable to earnings and profits shall be an amount which is not in excess of the redeemed stock's ratable share of the earnings and profits of the company accumulated after February 28, 1913. The effect of this provision is to allocate to each share of stock (whether or not redeemed) an equal amount of the company's accumulated earnings and profits at the time of the redemption. Paragraph (3) of subsection (l) applies only to such distributions made after December 31, 1962. The application of subsection (l)(3) of section 312 may be illustrated by the following example: Corporation F, a foreign investment company, has accumulated earnings and profits of \$10,000 on December 31, 1963, on which date Corporation F redeems shareholder A's stock for cash in the amount of \$4,000. A is a 20-percent shareholder. Under the amendment the earnings and profits of the corporation are reduced by only \$2,000 (20 percent of \$10,000).

Paragraph (2) of section 15(b) of the bill amends section 751(d)(2) of the code (relating to inventory items of a partnership which have

appreciated substantially in value) by adding new subparagraphs (C) and (D) which provide treatment for the sale or exchange of an interest in a partnership which holds stock in a foreign investment company. The amendment treats foreign investment company stock as an inventory item of the partnership under subsection (d)(2) of section 751. If an interest in a partnership, holding stock in a foreign investment company, is sold or exchanged, and if section 1246(a) would apply to the gain on the sale or exchange of such stock were such stock sold or exchanged by the partnership, the amount received for such interest which is attributable to the inventory items under section 75(d)(2) (including foreign investment company stock) will be taxed at ordinary income rates, provided under section 751(d)(1) the substantial appreciation tests for inventory items of the partnership are satisfied.

Paragraph (3) of section 15(b) of the bill amends section 1223 of the code (relating to holding period of property) by redesignating paragraph (10) as paragraph (11) and adding a new paragraph (10). Paragraph (10) requires a taxpayer in determining the period for which he held certain trust certificates to which section 1246(d) applies (relating to entities holding foreign investment company stock), or the period for which he held stock to which such section applies, to include the period for which the trust or corporation held the stock of foreign investment companies.

(c) *Effective date.*—Subsection (c) of section 15 of the bill provides that the amendments made by section 15 are to apply with respect to taxable years beginning after December 31, 1962.

SECTION 16. GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS

(a) *Treatment of gain from the redemption, cancellation, or sale of stock in certain foreign corporations.*—Subsection (a) of section 16 of the bill amends part IV of subchapter P of chapter 1 (relating to special rules for determining capital gains and losses) by adding after section 1247 (as added by sec. 15 of the bill) a new section 1248.

Redemptions and liquidations

Subject to the limitations of subsection (c), subsection (a) of the new section 1248 applies to (1) redemptions of stock in foreign corporations which are treated as exchanges under section 302(a), including redemptions to which section 304 applies; (2) cancellation of stock in complete liquidation of foreign corporations which are treated as exchanges under section 331(a)(1), including liquidations of subsidiary corporations if section 332 does not apply; and (3) cancellation of stock in partial liquidation of foreign corporations which are treated as exchanges under section 331(a)(2). The new section 1248 does not apply to a distribution in redemption of stock to which section 302(d) applies, or to a distribution of property to which section 303 applies.

Subsection (a) provides that United States persons (as defined in sec. 7701(a)(30) of the code, as added by sec. 9(h) of the bill) realizing gain on such exchanges are required to include in gross income as a dividend so much of the gain as is equal to the United States person's proportionate share of the earnings and profits of the foreign

corporation accumulated after February 28, 1913. That part of the gain in excess of such amount is not affected by the bill.

A United States person's proportionate share of earnings and profits is determined on the basis of his percentage of stock ownership on the date of redemption, liquidation, or partial liquidation, or if a distribution is one of a series of distributions in redemption of all the stock of a corporation at the date of each redemption. Thus, if a United States person owns 100% of the stock of a foreign corporation on the date a foreign corporation is liquidated, the gain realized on the exchange, to the extent of 100% of the earnings and profits of the foreign corporation, would be included in gross income as a dividend.

To the extent gain is included in gross income as a dividend, the applicable rules of subpart A of part III of subchapter N, relating to foreign tax credits, apply. Thus, foreign tax credits for amounts allowed under section 901(b) with respect to taxes paid, and section 902 with respect to taxes deemed to be paid, are allowable if the United States person chooses to have the benefits of such sections. The rules of section 11 of the bill, relating to the gross-up of dividends from foreign corporations, apply to dividends under this section in the same manner and to the same extent as section 11 applies to any other dividend. There is no foreign tax credit with respect to any taxes paid by the foreign corporation as to the portion of the gain which is not treated as a dividend.

The basis of property received in a distribution to which subsection (a) applies will continue to be determined under existing law relating to such taxable exchanges.

Sales and other exchanges

Subject to the limitations of subsection (c), subsection (b) of the new section 1248 applies to all sales of stock in foreign corporations, and to all taxable exchanges of stock in foreign corporations, other than exchanges to which subsection (a) applies, in which gain is realized.

If a United States person sells or exchanges stock in a foreign corporation, the gain recognized is treated as gain from the sale or exchange of property which is not a capital asset to the extent of such person's proportionate share of the earnings and profits of the foreign corporation accumulated during the period the stock sold or exchanged was held by such United States person. For this purpose, earnings and profits are determined on the basis of the time each share of stock sold or exchanged was held, as determined under section 1223. Thus, if 100% of the stock of a foreign corporation was held for five years, and if 50% was held for the prior five-year period, the United States person's proportionate share of the earnings and profits would be the total earnings and profits for five years and 50% of the earnings and profits for the prior five-year period. That part of gain in excess of such amount is treated as provided by the code without regard to the new section 1248.

The earnings and profits of a foreign corporation are not reduced by any amount included in gross income under subsection (b).

Limitations

Subsection (c) of new section 1248 contains six limitations on the application of the general rules of subsections (a) and (b). In addition to these limitations, section 1248 would be inapplicable to exchanges described in sections 332, 351, 354, 355, 356, or 361 of the code if before such exchange, as prescribed in section 367, it has been established to the satisfaction of the Secretary of the Treasury or his delegate that such exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

Paragraph (1) provides that subsections (a) and (b) apply to a sale or exchange of stock in a foreign corporation only if the foreign corporation is a controlled foreign corporation, as defined in section 954 (added by sec. 13 of the bill), on the date of the sale or exchange, or, if not a controlled foreign corporation on such date, if the foreign corporation was a controlled foreign corporation on any day in the five-year period ending on the date of sale or exchange.

Paragraph (2) provides that subsections (a) and (b) apply to a sale or exchange of stock in a foreign corporation (subject to the limitations of par. (1)) only if the United States person whose stock is sold or exchanged can be considered, by applying the rules of constructive ownership of section 955 (added by sec. 13 of the bill), as being the owner, directly or indirectly, of 10% or more of the total combined voting power of all classes of stock entitled to vote of the foreign corporation on the date of sale or exchange or at any time during the five-year period ending on the date of the sale or exchange. It is not necessary that the United States person own such amount of stock on the date of sale or exchange or have owned such amount on a day when the foreign corporation was a controlled foreign corporation.

Paragraph (3) of section 1248(c) correlates section 1248 with section 951 (added by sec. 13 of the bill) by reducing the amount of gain considered a dividend under subsection (a), or as gain from the sale or exchange of property which is not a capital asset under subsection (b), by the United States person's proportionate share of earnings and profits of the foreign corporation, attributable to the stock sold or exchanged, previously included in the gross income of the United States person by the application of subpart F of part III of subchapter N. However, amounts previously included in the gross income of the United States person under section 951 are reduced by amounts subsequently distributed by the foreign corporation and excluded from gross income of the United States person under section 956.

The application of this paragraph may be illustrated by the following example involving United States person X who owns 100% of the stock of foreign corporation A. X purchased the stock on January 1, 1964 for \$100,000 and sold the stock on January 1, 1966 for \$115,000. For the year 1964, corporation A had subpart F income of \$10,000 which was included in the gross income of X under section 951. Corporation A had no earnings and profits for the year 1965, but made a \$5,000 distribution out of 1964 earnings and profits and thus excludible from gross income of X under section 956. For the year 1966, X

is required to include \$10,000 in gross income as a long-term capital gain, which amount is computed as follows:

(i) Amount of gain:		
(a) Amount realized	-----	\$115, 000
(b) Adjusted basis:		
Cost	-----	\$100, 000
Increased by amount included in gross income under section 951 (sec. 958(a))	-----	10, 000
		110, 000
Reduced by amount excluded from gross income under section 956 (sec. 958(b))	-----	5, 000
		Adjusted basis-----
		105, 000
(c) Amount of gain ((a) minus (b))	-----	10, 000
(ii) Amount of gain considered as gain from the sale or exchange of property which is not a capital asset (sec. 1248(b)):		
(a) X's proportionate share of earnings and profits accumulated during the period the stock sold was held by X (\$10,000 of earnings and profits for 1964, reduced by \$5,000 distributed during 1965)	-----	\$5, 000
(b) X's proportionate share of earnings and profits previously included in the gross income of X under section 951 (\$10,000, reduced by distributions excluded from the gross income of X under section 956, \$5,000)	-----	5, 000
(c) Gain—considered as gain from the sale or exchange of property which is not a capital asset ((a) minus (b))	-----	0
(iii) Amount of gain from the sale of a capital asset held for more than 6 months (item (i) minus item (ii))	-----	10, 000

Paragraph (4) provides that subsections (a) and (b) do not apply to a distribution of property to a United States person by a foreign corporation in redemption of part or all of the stock of such corporation to which section 303, relating to distributions in redemption of stock to pay death taxes, applies.

Paragraph (5) provides that subsection (b) does not apply to gain recognized because of the receipt of additional consideration on exchanges to which section 356 applies.

Paragraph (6) provides that the amount includible in gross income under subsections (a) or (b) shall not include any amount treated as a dividend, as gain from the sale of an asset which is not a capital asset, or as gain from the sale of an asset held for not more than six months, under any other provision of the code.

Taxpayer to establish earnings and profits

Subsection (d) of the new section 1248 provides that the United States person selling or exchanging the stock must establish the amount of earnings and profits of the foreign corporation to be taken into account under subsections (a) and (b). If the United States person does not establish the amount of earnings and profits to be taken into account, his entire gain is treated as a dividend under subsection (a), or as gain from the sale or exchange of property which is not a capital asset under subsection (b), whichever is applicable.

(b) *Clerical amendment.*—Subsection (b) of section 16 of the bill conforms the table of sections for part IV of subchapter P to the amendment made by subsection (a) of section 16 of the bill.

(c) *Effective date.*—Subsection (c) of section 16 of the bill provides that the amendments made by section 16 are to apply with respect to sales or exchanges occurring after the date of the enactment of the bill.

SECTION 17. TAX TREATMENT OF COOPERATIVES AND PATRONS

(a) *In general.*—Subsection (a) of section 17 of the bill amends the Internal Revenue Code of 1954 by adding to chapter 1 a new subchapter T (relating to cooperatives and their patrons) consisting of part I, tax treatment of cooperatives, part II, tax treatment by patrons of patronage dividends, and part III, definitions and special rules.

PART I—TAX TREATMENT OF COOPERATIVES

Part I of subchapter T consists of section 1381, organizations to which such part applies, section 1382, taxable income of cooperatives, and section 1383, computation of tax where cooperative redeems nonqualified written notices of allocation.

SECTION 1381. ORGANIZATIONS TO WHICH PART APPLIES

(a) *In general.*—Subsection (a) of section 1381 provides that part I of subchapter T is to apply to any organization which is exempt from tax under section 521 (relating to exemption of farmers' cooperatives) and to any corporation operating on a cooperative basis. Part I is not applicable, however, to any organization (1) which is exempt from income taxes (other than an exempt farmers' cooperative described in sec. 521); (2) which is subject to the provisions of part II of subchapter H (relating to mutual savings banks, etc.); (3) which is subject to the provisions of subchapter L (relating to insurance companies); or (4) which is engaged in furnishing electric energy, or providing telephone service, to persons in rural areas. Thus, part I of the new subchapter T does not apply to any cooperative exempt from tax under section 501. Nor does it apply to a cooperative which generates or transmits electricity for use by persons living in rural areas.

(b) *Tax on certain farmers' cooperatives.*—Subsection (b) of section 1381 provides that the farmers' cooperatives described in section 521 are subject to corporate income taxes. This is the same provision as the provision presently contained in section 522.

SECTION 1382. TAXABLE INCOME OF COOPERATIVES

(a) *Gross income.*—Subsection (a) of section 1382 provides that, except as provided in section 1382(b), all cooperatives to which part I of the new subchapter T applies must compute gross income without any adjustment (as a reduction in gross receipts, an increase in cost of goods sold, or otherwise) for amounts allocated or distributed to patrons out of net earnings.

(b) *Patronage dividends.*—Subsection (b)(1), applicable to both taxable and exempt cooperatives, provides that in determining the taxable income of a cooperative there are not to be taken into account

certain patronage dividends paid in money, qualified written notices of allocation, or other property (other than nonqualified written notices of allocation). Under this subsection, the patronage dividends which are not to be taken into account in computing taxable income for a taxable year are those which are paid during the payment period for that taxable year (as defined in sec. 1382(d)) with respect to patronage occurring during such taxable year.

Under subsection (b)(2), also applicable to both taxable and exempt cooperatives, certain amounts paid in money or other property (except written notices of allocation) in redemption of nonqualified written notices of allocation are not to be taken into account in determining the taxable income of a cooperative. The amounts described in subsection (b)(2) which are not to be taken into account for a taxable year are those which are paid during the payment period for that taxable year in redemption of nonqualified written notices of allocation which were paid as patronage dividends during the payment period for the taxable year during which the patronage occurred.

Subsection (b) also provides that amounts described in such subsection which are not taken into account in determining taxable income are to be treated for purposes of the 1954 Code in the same manner as items of gross income and corresponding deductions therefrom. Thus, for example, in determining the amount omitted from gross income for purposes of section 6501(e) (relating to period of limitations where there are omissions from gross income), amounts paid as patronage dividends (though not required to be taken into account in determining taxable income) are to be treated as amounts properly includible in gross income.

(c) *Deduction for nonpatronage distributions, etc.*—In the case of a farmers' cooperative which is exempt under section 521, certain deductions (in addition to other deductions allowed under chapter 1) are allowed under subsection (c) of the new section 1382. Subsection (c)(1) allows a deduction for dividends paid by such a cooperative during the taxable year on its capital stock. This deduction is the same in substance as that currently allowed under section 522(b)(1)(A).

Subsection (c)(2)(A) allows a deduction for amounts paid during the payment period for a taxable year, on a patronage basis, out of earnings of that taxable year derived either from business done for the United States or from sources other than patronage. A deduction is allowed by subsection (c)(2)(A), however, only for amounts paid in money, qualified written notices of allocation, or other property (except nonqualified written notices of allocation). For purposes of the deduction allowed by subsection (c)(2)(A), amounts are considered as paid on a patronage basis if they are paid in proportion, insofar as is practicable, to the amount of business done by or for patrons during the period to which such amounts are attributable.

In addition to the deductions allowed by subsections (c)(1) and (c)(2)(A), a deduction is allowed under subsection (c)(2)(B) for amounts paid in money or other property (except written notices of allocation) in redemption of a nonqualified written notice of allocation which was previously paid during the payment period for a taxable year on a patronage basis to a patron out of earnings derived during that taxable year either from business done for the United States or

from sources other than patronage. A deduction under subsection (c)(2)(B) will be allowed for a taxable year only for amounts paid during the payment period for that taxable year.

For purposes of the new subchapter T, a written notice of allocation is considered paid when it is issued to the patron. Amounts paid in redemption of a nonqualified written notice of allocation which are in excess of the stated dollar amount of such written notice of allocation and which in effect constitute interest may be deducted by the cooperative as interest. These excess amounts will be treated by the distributee as interest and not as a patronage dividend.

(d) *Payment period for each taxable year.*—Subsection (d) of section 1382 contains the definition of the “payment period for each taxable year.” It provides that the payment period for any taxable year is the period beginning with the 1st day of such taxable year and ending with the 15th day of the 9th month following the close of such year. Thus, a cooperative has 8½ months after the close of a taxable year in which to pay patronage dividends out of the net earnings from patronage occurring during that taxable year. Any patronage dividend which it pays after that time must be taken into account by the cooperative in computing its taxable income; and the cooperative will be allowed no subsequent adjustment for any amount it pays in redemption of a written notice of allocation which was paid as a part of such patronage dividend. The same general rules apply with respect to nonpatronage distributions made on a patronage basis.

(e) *Products marketed under pooling arrangements.*—Subsection (e) of section 1382 provides a special rule for determining, for purposes of section 1382(b), when the patronage is considered to have occurred in the case of a pooling arrangement for the marketing of products. Under this rule, the patronage will (to the extent provided in regulations prescribed by the Secretary of the Treasury or his delegate) be treated as occurring during the taxable year in which the pool closes. For example, farmer A delivers to the X cooperative 100 bushels of wheat on August 15, 1963, at which time he receives a “per bushel” advance. On October 15, 1963, he receives an additional “per bushel” payment. The pool sells some of its wheat in 1963 and the rest in January of 1964. The pool is closed on February 15, 1964. For purposes of section 1382(b), A’s patronage is considered as occurring in 1964.

Section 1382 has no effect on, and is not intended to change, existing rules with respect to the time at which items are taken into account in computing the cooperative’s gross income. For example, a tobacco stabilization cooperative may be required by the Commodity Credit Corporation to apply a portion of its proceeds from the sale of tobacco against loans on other crop years. In a letter to the Department of Agriculture dated October 11, 1955, the Internal Revenue Service held that this portion of the proceeds was not includible in the cooperative’s gross income until the cooperative had an unrestricted right to such portion. Section 1382 will in no way change this holding. Under section 1382(f), the Secretary of the Treasury or his delegate may provide by regulations that, in such a case, the patronage to which this portion of the proceeds relates is to be considered to have occurred during the taxable year when the cooperative first had an unrestricted right to such portion. This will permit the cooperative to pay these proceeds out as patronage dividends during the payment period for

such later year. If the conditions of section 1382(b) are met, such patronage dividends need not be taken into account in determining the taxable income of the cooperative for such later year. Section 1382(f) permits the Secretary of the Treasury or his delegate to provide similar rules as to when patronage is considered to have occurred in other cases when earnings are includible in the gross income of a cooperative for a taxable year after the patronage occurred.

SECTION 1383. COMPUTATION OF TAX WHERE COOPERATIVE REDEEMS
NONQUALIFIED WRITTEN NOTICES OF ALLOCATION

Section 1383 provides a special rule for computing a cooperative's tax for a year when it redeems nonqualified written notices of allocation.

(a) *General rule.*—Section 1383(a) provides that if, for a taxable year, a cooperative is allowed a deduction under section 1382 (b)(2) or (c)(2)(B) for amounts it pays in redemption of nonqualified written notices of allocation, then its tax for that year shall be whichever of the following is the smaller:

(1) The tax for the taxable year computed with the deduction for the amounts paid in redemption of the nonqualified written notices of allocation, or

(2) An amount equal to—

(A) the tax for the taxable year computed without such deduction, minus

(B) the decrease in tax under chapter 1 for the prior taxable year (or years) which would result solely from treating such nonqualified written notices of allocation as qualified written notices of allocation.

(b) *Special rules.*—Section 1383(b) provides three special rules applying to the alternative tax computations based on the decrease in tax for the prior taxable years. Under section 1383(b)(1), if the decrease in tax for the prior taxable year (or years) exceeds the tax for the current year (computed without any deduction for amounts paid in redemption of nonqualified written notices of allocation), the excess is to be considered to be a payment of tax on the last day prescribed by law for the payment of tax for the current taxable year, and is to be refunded or credited in the same manner as if it were an overpayment for the current taxable year.

Section 1383(b)(2) provides that, for purposes of computing the decrease in tax for the prior taxable year, the nonqualified written notices of allocation which are treated as qualified written notices of allocation are to be considered to have a stated dollar amount equal to the amount paid in redemption of such written notices of allocation to the extent such amount is allowable as a deduction under section 1382 (b)(2) or (c)(2)(B).

Section 1383(b)(3) provides that if the alternative tax computation provided by section 1383(a)(2) is used, then the deduction otherwise allowable for the current year by reason of the redemption of nonqualified written notices of allocation is not to be allowed for any purpose under the 1954 Code.

The application of section 1383 may be illustrated by the following example:

The X Cooperative (which reports its income on a calendar year basis) pays patronage dividends of \$100 in nonqualified written notices of allocation on February 1, 1964, with respect to patronage occurring in 1963. Since the patronage dividends were paid in nonqualified written notices of allocation, the X Cooperative must include the \$100 in gross income and is not allowed a deduction for that amount for 1963. On December 1, 1966, the X Cooperative redeems these nonqualified written notices of allocation for \$50. Section 1382(b)(2) provides that the X Cooperative is not to take that \$50 into account in determining its taxable income for 1966. However, if the X Cooperative otherwise has a loss for 1966 and, therefore, owes no tax for that year, it may make the computation under the alternative method provided in section 1383(a)(2). Under this alternative, it would be permitted a credit or refund of the decrease in tax for 1963 which results from recomputing the 1963 tax liability as if patronage dividends of \$50 had been paid for 1963 in qualified written notices of allocation. If this alternative is used, the X Cooperative cannot then use the \$50 deduction otherwise allowable for 1966 to increase its net operating loss carryback or carryforward. If the X Cooperative also redeems on December 1, 1966, nonqualified written notices of allocation which were paid as patronage dividends on February 1, 1965, with respect to patronage occurring in 1964, it would be allowed a credit or refund for the decrease in tax for 1964. It could not, however, apply one method for computing the tax with respect to the redemption in 1966 of the nonqualified written notices of allocation paid in 1964 and the other method with respect to the redemption in 1966 of the nonqualified written notices of allocation paid in 1965.

PART II—TAX TREATMENT BY PATRONS OF PATRONAGE DIVIDENDS

Part II of subchapter T, consisting of section 1385, deals with the patron's tax treatment of patronage dividends and amounts paid by an exempt farmers' cooperative from nonpatronage earnings.

SECTION 1385. AMOUNTS INCLUDIBLE IN PATRONS GROSS INCOME

(a) *General rule.*—Subsection (a)(1) requires the patron to include in gross income the amount of any patronage dividend (other than one described in sec. 1385(b)) received during the taxable year from a taxable or an exempt cooperative to which part I of subchapter T applies, if paid in money, a qualified written notice of allocation, or other property (except a nonqualified written notice of allocation). Subsection (a)(2) requires inclusion in the gross income of the patron of distributions (other than those paid in nonqualified written notices of allocation) paid on a patronage basis by a farmers' cooperative exempt under section 521 with respect to earnings derived either from business done for the United States or from sources other than patronage. The patron must include patronage dividends in gross income for the taxable year during which they are received, even though the cooperative does not take them into account in computing taxable income for its preceding taxable year because they were paid during the payment period for such preceding taxable year. Patronage dividends are includible in the patron's gross income under section 1385 even if the cooperative is not permitted any adjustment for such

patronage dividends because they were not paid during the payment period for the taxable year in which the patronage occurred.

(b) *Exclusion from gross income.*—Subsection (b)(1) of section 1385 excludes from gross income a patronage dividend, or an amount received on the redemption, sale, or other disposition of a nonqualified written notice of allocation which was previously paid as a patronage dividend, which is properly taken into account as an adjustment to basis of property. For example, if a patronage dividend is attributable to the purchase of a capital asset or property used in a trade or business, such patronage dividend will not be included in the distributee's gross income but will reduce the basis of such asset or property. Subsection (b)(2) provides that a patronage dividend, or an amount received on the redemption, sale, or other disposition of a nonqualified written notice of allocation which was previously paid as a patronage dividend, which is paid to a patron with respect to the purchase of a personal, rather than a business, expense item, is not includible in gross income. These provisions are to be applied under regulations prescribed by the Secretary of the Treasury or his delegate.

(c) *Treatment of certain nonqualified written notices of allocation.*—Subsection (c)(1) of section 1385 describes the kind of nonqualified written notices of allocation to which section 1385(c) applies. This subsection applies to a nonqualified written notice of allocation which was paid as a patronage dividend by a taxable or an exempt cooperative, and to a nonqualified written notice of allocation which was paid on a patronage basis by a farmers' cooperative exempt under section 521 out of earnings derived either from business done for the United States or from sources other than patronage.

Subsection (c)(2)(A) of section 1385 provides that such a nonqualified written notice of allocation is to have a zero basis in the hands of the patron to whom it was paid. Subsection (c)(2)(B) of section 1385 provides that the basis of a nonqualified written notice of allocation described in subsection (c)(1) acquired from a decedent is to be its basis in the hands of the decedent. Any amount which the beneficiary is required to report as ordinary income on the redemption, sale, or other disposition of such written notice of allocation is income in respect of a decedent under section 691 of the code. Subsection (c)(2)(C) provides that any gain on the redemption, sale, or other disposition of a nonqualified written notice of allocation described in subsection (c)(1) is to be ordinary income to the extent that its stated dollar amount exceeds its basis. This is true whether such gain is realized by the patron who received the nonqualified written notice of allocation or any subsequent holder. For example, farmer A receives a patronage dividend paid in the form of a nonqualified written notice of allocation which is attributable to the sale of his crop to the X Cooperative. The stated dollar amount of the nonqualified written notice of allocation is \$100. The basis of the written notice of allocation in the hands of farmer A is zero and he must report any amount up to \$100 received by him on its redemption, sale, or other disposition as ordinary income. If farmer A gives the written notice of allocation to his son B, B takes farmer A's (the donor's) basis which is zero, and any gain up to \$100 which B later realizes on its redemption, sale, or other disposition is ordinary income. Similarly, if A dies before realizing any gain on the nonqualified written notice of allocation, B, his legatee, has a zero basis for such written notice of allocation.

tion and any gain up to \$100 which he then realizes on its redemption, sale, or other disposition is also ordinary income. Any amounts realized on the redemption, sale, or other disposition of such nonqualified written notice of allocation in excess of \$100 will be treated under the applicable provisions of the code. These provisions in section 1385(c)(2)(C) are not intended to reflect in any way on how gain on the redemption, sale, or other disposition of a written notice of allocation would be treated under existing law.

PART III—DEFINITIONS; SPECIAL RULES

Part III of subchapter T, consisting of section 1388, defines “patronage dividend,” “written notice of allocation,” “qualified written notice of allocation,” and “nonqualified written notice of allocation,” and provides special rules for determining amounts paid or received.

SECTION 1388. DEFINITIONS; SPECIAL RULES

(a) *Patronage dividend.*—Under subsection (a) of section 1388, the term “patronage dividend” means an amount paid to a patron by a cooperative to which part I of subchapter T applies (1) on the basis of quantity or value of business done with or for such patron, (2) under an obligation to pay such amount, which obligation existed before the cooperative received the amount, and (3) which is determined by reference to the net earnings of the cooperative from business done with or for its patrons. It is made clear that there are not to be included as patronage dividends any amounts which are out of earnings other than from business done with or for patrons, or any amounts paid to patrons which are attributable to the patronage of other patrons to whom no amounts are paid, or to whom smaller amounts are paid, with respect to substantially identical transactions. Thus, if a cooperative does not pay any patronage dividends to nonmembers, any portion of the amounts paid to members which is out of net earnings from patronage with nonmembers, and which would have been paid to the nonmembers if all patrons were treated alike, is not a patronage dividend.

(b) *Written notice of allocation.*—The term “written notice of allocation” is defined in subsection (b) of section 1388 to mean any capital stock, revolving fund certificate, retain certificate, certificate of indebtedness, letter of advice, or other written notice, which discloses to the recipient the stated dollar amount allocated to him, and the portion thereof, if any, which constitutes a patronage dividend.

This definition is applicable both to written notices of allocation paid as patronage dividends and to written notices of allocation paid with respect to nonpatronage earnings or earnings from business done for the United States.

(c) *Qualified written notice of allocation.*—Subsection (c)(1) of section 1388 contains the definition of “qualified written notice of allocation”. Subsection (c)(1)(A) provides, in the case of both taxable and exempt cooperatives, that the term “qualified written notice of allocation” includes a written notice of allocation which the patron may redeem in cash, at its stated dollar amount, at any time within a period beginning on the date such written notice of allocation is paid and ending not earlier than 90 days from such date. The

patron must be notified by the cooperative, in writing, at the time he receives the written notice of allocation, of this right of redemption. It is intended that this notice must be given separately to each patron and not in the form of a notice in a newspaper or posted at the cooperative's headquarters. If the patron does not exercise his option to redeem the written notice of allocation, he must, nevertheless, take it into account, at its stated dollar amount, in the manner provided in section 1385(a).

Subsection (c)(1)(B) of section 1388, also applicable to both taxable and exempt cooperatives, provides that the term "qualified written notice of allocation" also includes a written notice of allocation which the patron has consented to take into account at its stated dollar amount in the manner provided in section 1385(a). This consent must be made in the manner provided in subsection (c)(2) of section 1388.

Subsection (c)(2) of section 1388 provides the two different ways in which the consent to take written notices of allocation into account as provided in section 1385(a) may be made. The first way is to make such consent in writing. This consent must be made by the patron before the close of the cooperative's taxable year during which the patronage to which the written notice of allocation is attributable occurred. Such consent is, under subsection (c)(3)(A)(i), effective with respect to all patronage occurring during the taxable year of the cooperative in which such consent is made and, unless revoked as provided in subsection (c)(3)(B)(i), all subsequent taxable years. Subsection (c)(3)(B)(i) provides that such a consent may be revoked by the patron at any time. The revocation must be in writing and filed with the cooperative. Thus, any such written consent which is, by its terms, irrevocable is not a consent that would qualify a written notice of allocation under subsection (c)(1)(B). A revocation is only effective with respect to patronage occurring after the close of the cooperative's taxable year during which the revocation is filed with it. In the case of a patron participating in a pooling arrangement described in section 1382(e), a written consent may be made at any time before the close of the cooperative's taxable year during which the pool closes. Any subsequent revocation filed by the patron, however, would not be effective with respect to that pool.

The written consent described in the preceding paragraph is the only method by which a nonmember-patron may consent within the meaning of subsection (c)(1)(B). For a patron who is a member (or prospective member) of the cooperative, there is, however, another method by which he can consent to take written notices of allocation into account as provided in section 1385(a). In this case, the consent may be made by the patron by obtaining or retaining membership in the cooperative after—

(A) the cooperative has adopted a bylaw providing that membership in the cooperative constitutes such consent, and

(B) he has received a written notification and copy of such bylaw.

The bylaw described in (A) must be adopted by the cooperative after the date of enactment of this bill (the Revenue Act of 1962) and must contain a clear statement that membership in the coopera-

tive constitutes the prescribed consent. The following is an example of a bylaw provision which would meet this requirement:

Each person who hereafter applies for and is accepted to membership in this cooperative and each member of this cooperative on the effective date of this bylaw who continues as a member after such date shall, by such act alone, consent that the amount of any distributions with respect to his patronage occurring after -----, which are made in written notices of allocation (as defined in 26 U.S.C. 1388) and which are received by him from the cooperative, will be taken into account by him at their stated dollar amounts in the manner provided in 26 U.S.C. 1385(a) in the taxable year in which such written notices of allocation are received by him.

Before a patron shall be considered to have consented under this second alternative, he must receive the written notification and the copy of the bylaw, as provided in (B) above. In the case of a new member, he must receive the notification and the copy of the bylaw before he becomes a member. The written notification must inform the patron that this bylaw has been adopted and of its significance. It is intended that the notification and copy of the bylaw must be given to each individual separately and not in the form of a notice in a newspaper or posted at the cooperative's headquarters.

Under subsection (c)(3)(A)(ii) of section 1388, this alternative consent will be effective with respect to all patronage of the member-patron occurring after he receives the notification and copy of the bylaw provision. In the case of a pooling arrangement described in section 1382(e), the consent will only be effective with respect to the member's actual patronage occurring after he receives the notification and copy of the bylaw and shall not be effective with respect to any of his patronage under the pool before this time. Subsection (c)(3)(B)(ii) provides that this alternative consent will not apply to any patronage of the patron after he ceases to be a member of the cooperative or after the bylaw provision is repealed by the cooperative. In the case of a pooling arrangement, this refers to the time when the patronage actually occurred. Thus, if the patron resigns his membership in the cooperative during the period a pool is in operation, he will not be considered to have consented with respect to any of his patronage under the pool after the date of his resignation.

(d) *Nonqualified written notice of allocation.*—Subsection (d) of section 1388 defines “nonqualified written notice of allocation” to mean a written notice of allocation which is not described in section 1388(c).

(e) *Determination of amount paid or received.*—Subsection (e) of section 1388 provides that, for purposes of the new subchapter T, in determining amounts paid or received: (1) Property, other than a written notice of allocation, is to be taken into account at its fair market value, and (2) a qualified written notice of allocation is to be taken into account at its stated dollar amount. Thus, if a cooperative pays a patronage dividend in qualified written notices of allocation, and the requirements of section 1382 are met, the cooperative will not be required to take the stated dollar amounts of such written notices of allocation into account in determining its taxable income. Conversely, the patron receiving a qualified written notice of allocation

must take it into account, as provided in section 1385(a), at its stated dollar amount. If a cooperative pays a patronage dividend in non-qualified written notices of allocation, it is required to include the stated dollar amount thereof in gross income and is allowed no deduction (and the patrons are not required to include such amount in gross income) at the time such written notices of allocation are paid (or received).

In determining the amount of a patronage dividend which is paid by a cooperative, there is included the amount of tax which is deducted and withheld under section 3471 (added to the 1954 Code by section 19 of this bill). The amount of tax deducted and withheld is treated as a cash distribution to the patron. For example, if Cooperative X, which pays its patronage dividends through the use of qualified written notices of allocation, determines that it will pay patron A a patronage dividend of \$100 and this patronage dividend is subject to withholding at the rate of 20 percent under the new section 3471, it will issue patron A a qualified written notice of allocation with a stated dollar amount of \$80 and withhold and remit \$20 to the Government. In determining its taxable income, Cooperative X will, if all the conditions are met, not take \$100 into account. In turn, patron A, in computing his tax liability, will take \$100 into account as a patronage dividend under section 1385(a)—\$80 as the stated dollar amount of the qualified written notice of allocation and \$20 as a cash distribution.

SECTION 17. TAX TREATMENT OF COOPERATIVES AND PATRONS (Continued)

(b) *Technical amendments.*—Subsection (b) of section 17 of the bill makes certain technical amendments to reflect the provisions of the new subchapter T.

Paragraph (1) amends section 521(a) (relating to exemption of farmers' cooperatives from tax) to insert references to part I of the new subchapter T.

Paragraph (2) repeals section 522 (relating to tax on farmers' cooperatives exempt under sec. 521).

Paragraph (3) amends section 6044 to revise the provisions relating to information returns which must be filed by cooperatives. Under existing law, a cooperative must file an information return only with respect to patronage dividends which it pays. Paragraph (3) amends section 6044 to provide that a cooperative must, when required by the Secretary of the Treasury or his delegate, report on its information return (1) patronage dividends paid in cash, qualified written notices of allocation, or other property (except nonqualified written notices of allocation), (2) amounts paid in redemption of nonqualified written notices of allocation previously paid as a patronage dividend, and (3) in the case of an exempt farmers' cooperative, amounts described in section 1382(c)(2) (relating to amounts paid with respect to nonpatronage earnings). The cooperative may be required to report these amounts even though it must pay tax with respect to them because they were not paid within the prescribed time limits. Returns need only be filed, under section 6044, by organizations subject to the provisions of part I of subchapter T.

Section 6044 is also amended to remove the existing requirement that all payments of \$100 or more must be reported. Under the amended section 6044 the Secretary of the Treasury or his delegate may prescribe the minimum dollar amount of payments which must be reported.

Paragraph (4) amends section 6072(d) (relating to time for filing income tax returns of exempt cooperative associations) to extend the time for filing income tax returns of certain taxable cooperatives. Under this amendment, these cooperatives need not file returns for a taxable year until the 15th day of the 9th month following the close of such taxable year. Under existing law, these nonexempt cooperatives must file returns for a taxable year on or before the 15th day of the 3d month following the close of such taxable year. The taxable cooperatives which may take advantage of this filing date provision are those described in section 1381(a)(2) which either (1) are under an obligation to pay patronage dividends in an amount equal to 50 percent or more of net earnings from business done with or for patrons, or (2) actually paid patronage dividends in such an amount out of net earnings from business done with or for patrons during the most recent taxable year for which they had such net earnings. Under existing law, exempt farmers' cooperatives are not required to file returns for a taxable year until the 15th day of the 9th month following the close of such taxable year, and this rule is not changed.

(c) *Effective dates.*—Subsection (c) of section 17 of the bill prescribes the effective dates for subsections (a) and (b).

Paragraph (1) of subsection (c) provides that, in the case of cooperatives, the amendments made by subsections (a) and (b) of the bill will, except as provided in paragraph (3), apply to taxable years of organizations described in section 1381(a) beginning after December 31, 1962.

Paragraph (2) of subsection (c) provides that, in the case of patrons, section 1385 will, except as provided in paragraph (3), apply with respect to any amount received from any organization described in section 1381(a), to the extent that such amount is paid by such organization in a taxable year of such organization beginning after December 31, 1962.

Paragraph (3) of subsection (c) provides that, in the case of any money, written notices of allocation, or other property, paid by any organization described in section 1381(a)—

(A) before the first day of the first taxable year of such organization beginning after December 31, 1962, or

(B) on or after such first day with respect to patronage occurring before such first day,

the tax treatment of such money, written notices of allocation, or other property (including the tax treatment of gain or loss on the redemption, sale, or other disposition of such written notices of allocation) by any cooperative or patron is to be made under the 1954 Code without regard to the new subchapter T. For example, if a cooperative pays a patronage dividend during its taxable year beginning January 1, 1963, out of net earnings for its taxable year ending on December 31, 1962, the tax treatment of such a patronage dividend (including the determination of when it is considered paid) would be determined under existing law. Furthermore, the provisions of section 1382 (b)(2) and (c)(2)(B) (relating to deduction for amounts

paid in redemption of certain nonqualified written notices of allocation) and section 1383 (relating to computation of tax where a cooperative redeems nonqualified written notices of allocation) are not applicable to amounts paid in redemption of a written notice of allocation which was paid (whether before or after January 1, 1963) with respect to patronage occurring before such date.

SECTION 18. INCLUSION OF FOREIGN REAL PROPERTY IN THE GROSS ESTATE

(a) *Amendments to include foreign real property.*—Subsection (a) of section 18 of the bill amends sections 2031(a), 2033, 2034, 2035(a), 2036(a), 2037(a), 2038(a), 2040, and 2041(a) of the 1954 Code by striking from each section the language which requires the exclusion from the gross estate of real property situated outside of the United States. The result of these amendments, subject to the effective date provisions of subsection (b) of section 18, is to include in the gross estate of decedents who are citizens or residents of the United States, the fair market value of their interest in real property which is situated outside of the United States. Under existing law real property situated outside of the United States is excluded in determining the value of the gross estate.

(b) *Effective date.*—Subsection (b) of section 18 provides that the amendments which repeal the exclusion for real property situated outside of the United States are effective with respect to the estates of decedents dying after the date of the enactment of the bill. However, special provisions apply in the case of decedents dying after such date of enactment and before July 1, 1964.

Under one of these provisions, the value of real property situated outside of the United States is not included in the gross estate of the decedent under section 2033, 2034, 2035(a), 2036(a), 2037(a), or 2038(a) to the extent the decedent's interest in it was acquired before February 1, 1962. Under another of these special provisions, the value of real property situated outside the United States is excluded from the gross estate of a decedent who dies after the date of the enactment of the bill and before July 1, 1964, to the extent the property or interest therein was either held by the decedent and the surviving tenant in a joint tenancy or tenancy by the entirety before February 1, 1962, or, even though the joint tenancy or tenancy by the entirety was created on or after February 1, 1962, to the extent the property or interest therein was acquired by the decedent before February 1, 1962. Under still another of these special provisions, in the case of decedents dying after the date of the enactment of the bill and before July 1, 1964, the value of real property situated outside the United States is excluded from the gross estate to the extent that before February 1, 1962, it was subject to a general power of appointment possessed by the decedent.

For purposes of applying these three special provisions, the real property, interests therein, and general powers of appointment to which these special provisions apply, which are acquired by the decedent after January 31, 1962, by gift within the meaning of section 2511, or from a prior decedent by devise or inheritance, or by reason of death, form of ownership, or other conditions (including the exercise or non-exercise of a power of appointment), are treated as acquired before

February 1, 1962, if the donor or prior decedent acquired the property, his interest therein, or a power of appointment (whether or not a general power) in respect thereof, before that date. For example, assume that A, who bought foreign real property on December 1, 1961, dies on March 1, 1962, and by will leaves the property to B who dies after the date of the enactment of the bill and before July 1, 1964. In this example B will be treated as having acquired the property before February 1, 1962, since A, the prior decedent from whom B acquired the property, had acquired it before February 1, 1962.

For purposes of the amendments made by section 18(b) of the bill, substantial capital additions and improvements to real property made after January 31, 1962, are to be treated as separate properties. Capital additions or improvements to either commercial or residential property which do not materially increase the value of the property are to be disregarded.

SECTION 19. WITHHOLDING OF INCOME TAX AT SOURCE ON INTEREST, DIVIDENDS, AND PATRONAGE DIVIDENDS

(a) *In general.*—Subsection (a) of section 19 of the bill amends subtitle C of the Internal Revenue Code of 1954 by redesignating chapter 25 as chapter 26 and by inserting after chapter 24 a new chapter 25, entitled “Collection of Income Tax at Source on Interest, Dividends, and Patronage Dividends.” The new chapter provides a system for the withholding of tax at the source on interest, dividends, and patronage dividends. Chapter 25 consists of subchapters A, B, C, and D.

SUBCHAPTER A—INTEREST

SECTION 3451. INCOME TAX COLLECTED AT SOURCE ON INTEREST

(a) *Requirement of withholding.*—Section 3451(a) provides that, except as otherwise provided in chapter 25, every person who pays interest (as defined in sec. 3452) is to deduct and withhold on such interest a tax equal to 20 percent of the amount thereof. The person who pays interest is the person obligated on the debt out of which the interest arises. Therefore, even though remittance of interest to bondholders is made by use of an intermediary paying agent, such as a bank, the corporation obligated on the bonds is the person required to deduct and withhold tax on the interest.

The tax must be withheld at the time payment of interest is made. The term “payment” includes constructive payment. For example, A is a depositor in S Savings & Loan Co. S Company pays interest on deposits quarterly. On March 31, 1963, S Company credits the accounts of, and makes available to, its depositors the interest due for the first quarter of the year. On March 31, 1963, S Company must deduct and withhold an amount equal to 20 percent of the total amount credited to the accounts of depositors who do not have exemption certificates in effect, even though A does not present his account book to S Company to have the interest recorded until April 5, 1963.

Similarly, if the M Corporation pays interest on its outstanding coupon bonds on April 1, it is required to deduct and withhold an amount equal to 20 percent of the total interest payment on April 1

regardless of when the coupons are presented for collection. Thus, if A owns one of the bonds and presents on April 8, 1963, the coupon due on April 1, 1963, M Corporation is required to deduct and withhold the tax on April 1 and not at the time the coupon is presented by A.

However, in the case of series E United States savings bonds, withholding is not required until the bonds are surrendered or redeemed. If, pursuant to regulations prescribed under the Second Liberty Bond Act, the owner of a series E bond exchanges such obligation for another obligation issued under such act, and gain or loss is not recognized because of the provisions of section 1037 (or so much of sec. 1031 as relates to sec. 1037), withholding on the increment on the series E bond is not required until the obligation received in exchange is surrendered or redeemed. If the property received in the exchange consists not only of property permitted to be received without the recognition of gain but also of other property or money, then withholding is required at the time of the exchange to the extent of 20 percent of the gain recognized.

(b) *Payee unknown*.—Section 3451(b) provides that if the withholding agent is unable to determine the person to whom interest is payable, the tax is to be deducted and withheld at the time payment thereof would be made if such person were known. Thus, if a withholding agent is unable to ascertain the identity of the owner of certain bonds in respect of which interest is payable, or is unable to determine the true owner of bonds due to the existence of conflicting claims to such bonds asserted by two or more persons, the withholding agent is nevertheless required to deduct and withhold the tax on the amount of the interest payable in respect of such bonds at the time payment would have been made if the owner were known.

SECTION 3452. INTEREST DEFINED

(a) *General rule*.—Section 3452(a) defines the term “interest” as used in chapter 25 to mean:

(1) Interest (A) on evidences of indebtedness (including bonds, debentures, notes, and certificates) issued by a corporation with interest coupons or in registered form, and (B) to the extent provided in regulations prescribed by the Secretary of the Treasury or his delegate, on other evidences of indebtedness issued by a corporation of a type offered by corporations to the public. For this purpose, an instrument is in registered form if its transfer must be effected by the surrender of the old instrument and either the reissuance of the old instrument by the corporation to the new holder or the issuance by the corporation of a new instrument to the new holder. If an instrument can be transferred by endorsement it is not in registered form even though a list is maintained by the corporation of the negotiable instruments issued by it. Therefore, an evidence of indebtedness issued by a corporation falls into category (A) if it either is non-negotiable or, if negotiable, was issued with interest coupons.

To the extent provided in regulations prescribed by the Secretary of the Treasury or his delegate, interest on negotiable instruments issued by corporations without interest coupons (*i.e.*, evidences of indebtedness which do not fall into category (A)) will constitute interest on evidences of indebtedness falling into category (B) and subject to withholding under section 3451 if the instruments are of a

type offered by corporations to the public. However, it is not expected that the Secretary of the Treasury or his delegate will extend withholding to interest on instruments described in category (B) unless he is able to describe the instruments with such definiteness that both the issuers and holders thereof will encounter no difficulty in determining whether the interest is subject to withholding.

As used in section 3452(a)(1), the term "of a type offered by corporations to the public" refers to a type of instrument. In determining whether a particular instrument comes within the scope of the term it is immaterial whether the particular instrument (or any instrument of the issue of which it is a part) actually was offered to the public so long as it is of a type which is offered by corporations to the public. Therefore, in a case where an entire issue is offered by a corporation only to its shareholders, the instruments come within the scope of the term if they are of a type offered by corporations to the public. The term does not have reference to instruments of a type offered by corporations only to other corporations.

(2) Interest on deposits with persons carrying on the banking business. This paragraph includes interest payments by any individual or organization carrying on the banking business.

(3) Amounts (whether or not designated as interest) paid by a mutual savings bank, savings and loan association, building and loan association, cooperative bank, homestead association, credit union, or similar organization, in respect of deposits, investment certificates, or withdrawable or repurchasable shares.

(4) Interest on amounts held by an insurance company under an agreement to pay interest thereon. This paragraph includes interest paid with respect to dividends held by an insurance company, and interest on the proceeds of an insurance policy held by an insurer under an agreement to pay interest thereon. This paragraph does not apply to amounts which represent the so-called "interest element" in the case of annuity or installment payments under a life insurance or endowment contract.

(5) Interest on deposits with stockbrokers.

(6) Interest on obligations of the United States, including interest paid on postal savings certificates of deposit regardless of when the deposits were made.

(7) In the case of a non-interest-bearing obligation of the United States issued on a discount basis, and having a maturity date more than 1 year from the date of issue, the amount by which the amount paid on surrender or redemption exceeds the issue price. For example, the increment earned on series E United States savings bonds is subject to withholding when the bonds are surrendered or redeemed.

Generally, interest paid by individuals is not included within the definition of interest on which withholding is required. For example, A, an individual, makes installment payments upon the contract price of a washing machine purchased from M Company. No withholding is required on the amount of the installment payment which constitutes interest. Similarly no withholding is required on interest paid by one individual to another individual in connection with a loan. However, if B, an individual who is a stockbroker, retains sums of money belonging to C, a client, and pays interest thereon, B is required to deduct and withhold 20 percent of the amount of interest paid.

Except in the case of those United States obligations described in section 3452(a)(7), for purposes of chapter 25 discount is not treated as interest and there is no withholding on the amount of such discount.

(b) *Exceptions.*—Subsection (b) of section 3452 provides that for purposes of chapter 25 the term “interest” does not include:

(1) Interest on obligations described in section 103(a) (1) or (3) (relating to obligations of a State, etc.).

(2) Any amount paid by (A) a foreign government or international organization; (B) a foreign corporation not engaged in trade or business within the United States; (C) a nonresident alien individual not engaged in trade or business within the United States; or (D) a partnership not engaged in trade or business within the United States and composed in whole or in part of nonresident aliens. The term “international organization” means an organization defined as such under section 7701(a)(18) of the 1954 Code.

(3) Interest on deposits with persons carrying on the banking business paid to (A) a foreign corporation not engaged in trade or business within the United States; (B) a nonresident alien individual not engaged in trade or business within the United States; or (C) a partnership not engaged in trade or business within the United States and composed in whole or in part of nonresident aliens.

(4) Any amount paid by one corporation to another corporation, if both are members of the same affiliated group which filed a consolidated return under chapter 6 of the 1954 Code for the preceding taxable year of the affiliated group. In determining whether both corporations are members of the same affiliated group at the time the amount is paid, the rules provided under chapter 6 of the 1954 Code (relating to consolidated returns of income tax) will govern.

(5) Interest subject to withholding under section 1441 or 1442 by the person paying such interest or which would be so subject to withholding but for the fact that it is not treated as income from sources within the United States. Under this paragraph, if a person is required to withhold under section 1441 or 1442 (including a person required to withhold under such section by reason of sec. 1444(a)) on interest by reason of it being paid to a person who is a nonresident alien individual, a partnership not engaged in trade or business within the United States and composed in whole or in part of nonresident aliens, or a foreign corporation not engaged in trade or business within the United States, such person is not required to withhold on such interest under chapter 25.

(6) Any amount on which the withholding agent is required to deduct and withhold a tax under section 1451 (relating to tax-free covenant bonds), or would be so required but for section 1451(d) (relating to benefit of personal exemptions). Thus, the payment of interest on a tax-free covenant bond issued before January 1, 1934, is not subject to withholding under chapter 25. The fact that the person entitled to receive such interest files with the withholding agent a signed notice in writing, as provided in section 1451(d) of the 1954 Code, claiming the benefit of the deduction for personal exemptions provided in section 151 of the code, thereby relieving the withholding agent of any duty to withhold a tax under section 1451(a), does not abrogate the exemption provided in this paragraph.

(7) To the extent provided in regulations prescribed by the Secretary of the Treasury or his delegate, any amount payable with respect

to deposits in school savings accounts. It is expected that this exemption will apply to interest on deposits made by students of an elementary or secondary school under a program participated in by the school for the purpose of teaching thrift.

(8) Any of the following amounts if paid to a State, a foreign government, or an international organization: (A) Interest on deposits with persons carrying on the banking business; (B) amounts (whether or not designated as interest) paid by a mutual savings bank, savings and loan association, building and loan association, cooperative bank, homestead association, credit union, or similar organization, in respect of deposits or nontransferable certificates or shares; or (C) in the case of a non-interest-bearing obligation of the United States issued on a discount basis, and having a maturity date more than 1 year from the date of issue, the amount by which the amount paid on surrender or redemption exceeds the issue price. In order for payors to effect an exemption for these amounts it is contemplated that they will require a statement from the payee identifying itself as a State, foreign government, or international organization.

(c) *Exemption for United States.*—Subsection (c) of section 3452 provides that the Secretary of the Treasury may authorize exemption from withholding on interest paid by the United States or any wholly owned agency or instrumentality thereof to the United States or any wholly owned agency or instrumentality thereof if withholding on the interest will cause a burden or expense which can be avoided by granting the exemption. For example, the Secretary of the Treasury can exempt from withholding interest paid by the United States on obligations held by the Federal old-age and survivors insurance trust fund.

SUBCHAPTER B—DIVIDENDS

SECTION 3461. INCOME TAX COLLECTED AT SOURCE ON DIVIDENDS

(a) *Requirement of withholding.*—Section 3461(a) provides that, except as otherwise provided in chapter 25, every person who pays a dividend is to deduct and withhold on such dividend a tax equal to 20 percent of the amount thereof. The person who pays a dividend (as defined in sec. 3462(a)(1)) is the corporation upon whose stock the dividend is being paid. Therefore, even though remittance of the dividend to the shareholders is accomplished by the use of a disbursing agent, the corporation upon whose stock the dividend is paid remains the person paying the dividend and, consequently, the person required to deduct and withhold tax on the dividend. For example, the M Corporation on June 1, 1963, pays a dividend (through a disbursing agent) of 60 cents per share to its stockholders. A, an individual, owns 100 shares of M stock. The total amount of the dividend payable to A is \$60. The M Corporation is required to deduct and withhold the sum of \$12. If the total dividend paid and subject to withholding amounted to \$1,200,000, the corporation would remit to the Internal Revenue Service 20 percent of the total, or \$240,000.

The tax must be withheld at the time payment of a dividend is made. The term "payment" includes constructive payment, as was previously explained with reference to the payment of interest.

(b) *Payee unknown.*—Section 3461(b) provides that, if the withholding agent is unable to determine the person to whom the dividend

is payable, the tax is to be deducted and withheld at the time payment of the dividend would be made if such person were known. The explanation given above with respect to the comparable provision in section 3451, relating to interest, is equally applicable with reference to dividends.

(c) *Amount of dividend unknown.*—Section 3461(c) provides that if the withholding agent is unable to determine the portion of a distribution which is a dividend the tax required to be deducted and withheld under this section is to be computed on the entire amount of the distribution. Thus, the total amount of a distribution made by a regulated investment company, which includes gains realized on the sale or exchange of property, must be withheld upon if at the time such distribution is made the withholding agent is unable to determine the portion of the distribution which is a dividend.

SECTION 3462. DIVIDEND DEFINED

(a) *General rule.*—Section 3462(a) defines the term “dividend” as used in chapter 25 to mean: (1) Any distribution by a corporation which is a dividend as defined in section 316; and (2) any payment made by a stockbroker to any person as a substitute for a dividend (as so defined). Withholding is applicable to a dividend whether it is paid in cash or in property. A dividend paid by an insurance company to a policyholder, other than a dividend upon the capital stock of such insurance company, is not a dividend within the meaning of section 3462(a). Certain distributions which are dividends under the foregoing definition are exempt from the requirement of withholding under chapter 25. These exemptions are discussed below.

(b) *Exceptions.*—Section 3462(b) provides that, for purposes of chapter 25, the term “dividend” does not include:

(1) Any amount paid in the stock, or rights to acquire the stock, of the distributing corporation, if the distribution is not includible in the gross income of the recipient under the provisions of section 305 of the 1954 Code (relating to distributions of stock and stock rights).

(2) Distributions to shareholders which are treated for income tax purposes as amounts received on the sale or exchange of property, or distributions with respect to which gain or loss is not recognized to the shareholders. Capital gain dividends distributed by regulated investment companies or real estate investment trusts are within this exception.

In addition, tax is not required to be withheld on distributions subject to section 331 of the 1954 Code, relating to amounts distributed in complete or partial liquidation of a corporation. Also, a distribution which is made without the recognition of gain or loss under the provisions of section 355 (relating to distributions of stock and securities of a controlled corporation) is not subject to withholding.

(3) Any amount which is includible in gross income as a taxable dividend by reason of the provisions of section 302 (relating to redemptions of stock), section 306 (relating to disposition of certain stock), section 356 (relating to receipt of additional consideration in connection with certain reorganizations), or section 1081(e)(2) (relating to certain distributions pursuant to order of the Securities and Exchange Commission). Section 1081(e)(2) provides that, in the case of certain

exchanges not solely in kind, gain realized by the taxpayer may be taxed as a dividend.

(4) Any amount paid by a corporation to another corporation, if both corporations are members of the same affiliated group which filed a consolidated return under chapter 6 of the 1954 Code for the preceding taxable year of the affiliated group. In determining whether both corporations are members of the same affiliated group at the time the amount is paid, the rules provided under chapter 6 of the 1954 Code (relating to consolidated returns of income tax) will govern.

(5) Any amount which (A) is subject to withholding under section 1441 or 1442 (including an amount required to be withheld upon under such section by reason of sec. 1444(a)) by the person paying the amount, or (B) would be subject to withholding under section 1441 or 1442 by the person paying the amount but for the fact that it is attributable to income from sources outside the United States, or for the fact that the payor thereof is excepted from the application of section 1441(a) by the provisions of section 1441(c). Under this paragraph, if a corporation pays a dividend to a person who is a non-resident alien individual, a partnership not engaged in trade or business within the United States and composed in whole or in part of nonresident aliens, or a foreign corporation not engaged in trade or business within the United States, withholding will not be required under chapter 25.

(6) Any amount paid by a foreign corporation not engaged in trade or business within the United States.

(7) Amounts treated under section 1373 as amounts distributed as dividends. Thus, amounts of the undistributed taxable income of an electing small business corporation which a shareholder of such corporation must include in his gross income are not subject to withholding under the provisions of chapter 25. Amounts actually distributed by such a corporation to its shareholders are subject to the requirement of withholding if they are included within the definition of dividends contained in chapter 25.

(8) Amounts paid pursuant to the terms of a lease entered into before January 1, 1954, if under such lease the shareholders of the lessor corporation are entitled to such amounts without deduction for any tax which any law of the United States might require to be deducted and withheld on the payment of dividends. This exception is applicable to amounts paid under any lease entered into before January 1, 1954, if the lessee corporation has agreed to reimburse the shareholders of the lessor corporation for any tax required to be deducted and withheld upon the payment of dividends to them.

SUBCHAPTER C—PATRONAGE DIVIDENDS

SECTION 3471. INCOME TAX COLLECTED AT SOURCE ON PATRONAGE DIVIDENDS

(a) *Requirement of withholding.*—Section 3471(a) provides that every cooperative which is governed by part I of subchapter T of chapter 1 of the code (added by sec. 17 of the bill) must withhold 20 percent of certain amounts which it pays to its patrons. The

withholding tax imposed by section 3471(a) applies to amounts described in section 3472.

(b) *Payee unknown*.—Section 3471(b) is similar to sections 3451(b) and 3461(b), and provides that if the withholding agent is unable to determine the person to whom the amount described in section 3472 is payable, he nevertheless is required to withhold at the time payment would be made if the person were known.

SECTION 3472. AMOUNTS SUBJECT TO WITHHOLDING

(a) *General rule*.—Section 3472(a) provides that the amounts subject to withholding under section 3471 are—

(1) the amount of any patronage dividend (as defined in sec. 1388(a)) which is paid in money, qualified written notices of allocation (as defined in sec. 1388(c)), or other property (except nonqualified written notices of allocation as defined in sec. 1388(d)); and

(2) any amount described in section 1382(e)(2)(A) (relating to certain nonpatronage distributions) which is paid in money, qualified written notices of allocation, or other property (except nonqualified written notices of allocation) by an exempt farmers' cooperative described in section 521.

There is no withholding on amounts paid by a cooperative in nonqualified written notices of allocation or in redemption of nonqualified written notices of allocation.

(b) *Exceptions*.—Section 3472(b) lists the exceptions to the general rule. Paragraph (1) is similar to sections 3452(b)(4) and 3462(b)(4) and provides that amounts paid by one corporation to another are not subject to withholding if both corporations are members of the same affiliated group and a consolidated return was filed by such group for the preceding taxable year. Paragraph (2) is similar to sections 3452(b)(5) and 3462(b)(5) and provides that amounts subject to withholding by the cooperative under section 1441 or 1442 are not subject to withholding under section 3471. Also excepted under paragraph (2) are amounts which otherwise would be subject to withholding by the cooperative under section 1441 or 1442, but for the fact that they are not treated as income from sources within the United States. Paragraph (3) is similar to sections 3452(b)(2)(B) and 3462(b)(6) and provides that amounts paid by a foreign corporation not engaged in trade or business within the United States are not subject to the provisions of section 3471.

(c) *Exemptions for certain consumer cooperatives*.—Since patronage dividends attributable to the purchase of personal, living, or family items are not includible in the patron's gross income, section 3472(c) provides that any cooperative which the Secretary of the Treasury or his delegate determines to be primarily engaged in selling at retail goods or services of a type that are generally for personal, living, or family use shall be granted exemption from the withholding tax imposed by section 3471. For this exemption to apply, the cooperative must file an application with the Secretary of the Treasury or his delegate in accordance with regulations to be prescribed.

(d) *Determination of amount paid*.—Section 3472(d) provides that, in determining amounts paid, property other than a written notice of allocation is to be taken into account at its fair market value, and

qualified written notices of allocation are to be taken into account at their stated dollar amount. This treatment is consistent with that accorded under subchapter T of chapter 1. Thus, in determining the amount which must be deducted and withheld on a patronage dividend, the portion of the dividend paid in qualified written notices of allocation must be valued at the stated dollar amount of the written notices of allocation. For example, if a cooperative pays a patronage dividend of \$100, it can pay that dividend by a written notice of allocation with a stated dollar value of \$80; the remaining \$20 must be deducted and withheld by the cooperative and will be considered a patronage dividend paid in cash. No amount is required to be deducted and withheld on any amount of a patronage dividend paid in nonqualified written notices of allocation.

SUBCHAPTER D—GENERAL PROVISIONS

SECTION 3481. LIABILITY FOR RETURN AND PAYMENT OF WITHHELD TAX

(a) *General rule.*—Section 3481(a) provides that every person who is required to deduct and withhold tax under section 3451, 3461, or 3471 is to make a return of the tax required to be deducted and withheld by him during each quarter of his taxable year. The return must be filed and the tax must be paid to the officer designated in section 6151 (relating to time and place for paying tax shown on returns) on or before the last day of the first month following the close of the quarter of the taxable year during which it was deducted and withheld. Under the provisions of section 3481(a) a withholding agent is made liable for payment of the taxes required to be deducted and withheld on interest, dividends, and patronage dividends. A withholding agent's obligations will be satisfied by computing his tax by taking 20 percent of the total amount of dividends, interest, and patronage dividends on which he is required to deduct and withhold and which are paid within the period covered by the return, by filing the return, and by paying to the Government the amount so computed. He will not thereafter be liable to any person for the amount so deducted and withheld and paid to the Government.

(b) *Tax paid by recipient.*—In any case where, for whatever reason, a withholding agent fails to deduct and withhold the tax required by chapter 25 and the recipient of the interest, dividend, or patronage dividend actually pays the income tax he owes on such payment, the withholding agent is relieved of liability for payment of the tax which he failed to deduct and withhold. However, payment of the tax by the recipient does not relieve the withholding agent of liability for any penalties or additions to the tax otherwise applicable in respect of his failure to deduct and withhold the tax.

SECTION 3482. RETURN AND PAYMENT BY UNITED STATES

Under the provisions of section 3482 if the person required to file a return and pay the tax under the provisions of section 3481 is the United States or any wholly owned agency or instrumentality thereof, the return of the tax deducted and withheld may be made either by the officer or employee having control of the payment of the amount

subject to withholding, or by an officer or employee appropriately designated for that purpose.

SECTION 3483. EXEMPTION CERTIFICATES

(a) *General rules.*—Section 3483(a) provides for an exemption from withholding under chapter 25 on certain amounts paid to certain persons who file exemption certificates with the withholding agent.

The amounts which may be exempted from withholding under section 3483(a) in the case of individuals are all amounts subject to withholding under chapter 25 except (A) amounts described in section 3452(a)(1), relating to interest on evidences of indebtedness issued by corporations, (B) amounts described in section 3452(a)(3) which are paid in respect of a transferable certificate or share, and (C) amounts described in section 3452(a)(6), relating to interest on certain obligations of the United States.

Under the provisions of subsection (a)(1), any individual under age 18 who wishes to claim the exemption may do so by filing with any withholding agent, who pays amounts described above, an exemption certificate on which he certifies the date of his birth. If such a certificate is filed, all amounts described above which are payable by the withholding agent to the individual, on and after the effective date for the certificate and before the beginning of the calendar year during which the certificate indicates that the individual will attain the age of 18, are to be exempt from withholding under chapter 25. It is contemplated that the regulations will permit the individual to revoke such a certificate.

Exemption certificates are not required with respect to interest paid on school savings accounts which are excepted from withholding by section 3452(b)(7).

Under the provisions of subsection (a)(2), any individual who is over age 17 at the beginning of a calendar year may claim an exemption by filing with any withholding agent, who pays amounts described above, an exemption certificate on which he certifies that he will have attained the age of 18 before the close of the calendar year for which such certificate is filed and that he reasonably believes that he will not (after the application of the credits against tax provided by pt. IV of subch. A of ch. 1, other than the credits under secs. 31 and 39) be liable for the payment of any tax under chapter 1 for each of his taxable years any portion of which is included in the period for which such certificate will be in effect. Thus, an individual over age 17 who would be liable for payment of income tax for his taxable year except for the fact that tax was withheld on his wages, or on interest, dividends, or patronage dividends received by him, is not eligible for exemption under section 3483. If the taxable year of an individual over 17 is other than a calendar year, he must be able to make the certification as to nonliability for tax with respect to each taxable year any portion of which is included in the period for which the exemption certificate is effective. An individual who expects to file a joint return for any taxable year a part or all of which is included in the effective period of an exemption certificate must be able to certify that there will be no tax liability on such joint return. If a certificate is filed under the provisions of section 3483(a)(2), all amounts described above which are payable by the withholding agent to the individual

during the period the certificate is in effect are to be exempt from withholding under chapter 25. Except as the Secretary of the Treasury or his delegate may otherwise provide in regulations, an exemption certificate filed by an individual over age 17 will remain in effect only for the period beginning on the effective date of the certificate and ending at the close of the calendar year in which such period begins. It is expected that, if the Secretary or his delegate finds that certain individuals, such as those over age 65, generally remain in a nontaxable status, he may provide by regulations a procedure permitting exemption certificates filed by such individuals to remain effective for more than a year. The individual would, however, be required to revoke the certificate if he becomes taxable.

Under the provisions of section 3483(a)(3), an organization (other than a cooperative described in sec. 521) which is exempt from the tax imposed by chapter 1 may claim exemption from withholding on certain amounts. The amounts which may be exempted from withholding under this subsection are those amounts described in section 3452(a)(2) (relating to interest on deposits with persons carrying on the banking business), section 3452(a)(3) (relating to amounts paid by mutual savings banks, savings and loan associations, building and loan associations, etc., in respect of deposits, investment certificates, or withdrawable or repurchasable shares), and section 3452(a)(7) (relating to increment in value of series E savings bonds, etc.). A tax-exempt organization may claim the exemption by filing with any withholding agent who pays any of these amounts an exemption certificate on which it certifies that it is such an organization. If such a certificate is filed, all amounts described above which are payable by the withholding agent to the organization on and after the effective date for the certificate will (except as provided in sec. 3483(a)(3)(B)) be exempt from the requirement of withholding under chapter 25. Section 3483(a)(3)(B) provides that an exemption certificate filed by a tax-exempt organization will cease to be effective on the 30th day after the day on which the withholding agent with whom the certificate was filed is notified by either the organization or the Secretary of the Treasury or his delegate that the organization is no longer exempt from the tax imposed by chapter 1. If an organization ceases to be an organization which is exempt from the tax imposed by chapter 1, it must, within the time specified in regulations prescribed by the Secretary of the Treasury or his delegate, so notify each withholding agent with whom it has an exemption certificate in effect.

In general, a person entitled to exemption need file only one exemption certificate with any withholding agent. Thus, an individual who has two savings accounts in the same bank need file only one exemption certificate to exempt the interest on both accounts from withholding.

Withholding agents are required to honor an exemption certificate which on its face indicates that the person filing it is entitled to exemption, regardless of whether such person is in fact entitled to file it. Penalties for willfully filing a false and fraudulent certificate under section 3483 are provided in section 7205.

(b) *Exceptions and special rules.*—Subsection (b) of section 3483 provides exceptions and special rules governing the application of subsection (a). Paragraph (1) of subsection (b) provides that section 3483 is not to apply to any amount described in section 3452(a)(1),

section 3452(a)(3) paid in respect of a transferable certificate or share, or section 3452(a)(6). Thus, an exemption certificate filed with a savings and loan association does not apply with respect to interest paid on an investment certificate which is transferable. Paragraph (2) of subsection (b) provides that a separate certificate is to be filed in the case of each transaction involving the redemption of one or more obligations described in section 3452(a)(7) (relating to certain obligations of the United States issued on a discount basis, such as series E bonds). Paragraph (3) provides that the Secretary of the Treasury or his delegate may by regulation extend the exemption provided by section 3483 to amounts (other than dividends as defined in sec. 3462(a)) paid through nominees, amounts paid to custodians, and amounts paid jointly to two or more individuals. Thus, the exemption may not be extended to dividends paid on stock held in a street name.

Paragraph (4) provides that any exemption certificate under section 3483 will take effect on such day as is specified in accordance with regulations prescribed by the Secretary of the Treasury or his delegate. Paragraph (5) provides that exemption certificates under section 3483, and notices under section 3483(a)(3)(B), are to be in such form and contain such information as the Secretary of the Treasury or his delegate may prescribe by regulations.

A person who is entitled to file exemption certificates under section 3483 need not do so, but may file a claim for refund under the applicable provisions of section 3484 or 3485. A credit or refund of the tax deducted and withheld with respect to amounts for which no exemption from withholding is provided under section 3483 may be obtained under section 39 or 3484 in the case of an individual, or under section 39, 3485, or 3505 in the case of a tax-exempt organization.

SECTION 3484. REFUND OF TAX TO INDIVIDUALS

Section 3484 provides for refunds during the year, to certain individuals, of the tax deducted and withheld on interest, dividends, and patronage dividends received by them during the first three quarters of the taxable year. The amount refundable to an individual may not exceed his refund allowance which is determined in the manner provided in subsection (b). In general, a married couple which expects to file a joint income tax return for the taxable year is treated as one individual for purposes of obtaining a refund under section 3484.

(a) *General rule.*—Subsection (a) of section 3484 provides for a prompt refund (as an overpayment of tax) of the tax deducted and withheld under chapter 25 on amounts received by an individual during any quarter of his taxable year (other than the fourth quarter) to the extent such tax does not exceed his refund allowance at the time the claim is filed. The claim for refund filed during any quarter of the individual's taxable year may also include the tax withheld on amounts received by him during any prior quarter of the same taxable year if no allowable claim for refund has been filed under section 3484 with respect to such tax. No claim for refund may be filed under section 3484 with respect to tax withheld on amounts received during the fourth quarter of an individual's taxable year. Any tax withheld with respect to amounts received during the fourth quarter, together with tax withheld on amounts received during the first three quarters of such year for which no allowable claim for refund has been

filed under section 3484, may be claimed as a credit under section 39 against the tax imposed by chapter 1. A refund of tax is to be made under section 3484 only if the amount claimed and allowable equals or exceeds \$10.

(b) *Refund allowance*.—Subsection (b) of section 3484 provides that, for purposes of section 3484, the refund allowance of an individual as of the time a claim for refund is filed is an amount equal to the excess, if any, of—

(1) 22 percent of—

(A) the amounts of the deductions which, on the basis of facts existing at the time the claim for refund is filed, such individual would be allowed for the taxable year under section 151 (relating to deductions for personal exemptions), plus

(B) if the individual, at the time the claim for refund is filed, reasonably expects that he will be allowed a credit under section 37 for the taxable year, the amount which, at such time, such individual reasonably expects to be the amount of his retirement income (as defined in sec. 37(c) and as limited by sec. 37(d)) for the taxable year, less

(C) the amounts (other than amounts on which tax is required to be deducted and withheld under ch. 25) which, at the time the claim for refund is filed, such individual reasonably expects to be includible in his gross income for the taxable year; over

(2) the amounts of tax with respect to which an allowable claim for refund has been previously filed under section 3484 during the taxable year.

For purposes of paragraph (1)(C) of subsection (b), an individual who files a second, third, or fourth claim for refund under section 3484 for any taxable year may use the estimate for the preceding claim unless he reasonably expects the amounts referred to in subparagraph (C) to exceed such prior estimate by more than \$100. Thus, an individual who, at the time he files his second claim, reasonably expects that he will receive for the year \$150 more in wages than he estimated at the time he filed his first claim, must recompute his refund allowance on his second claim.

(c) *Married individuals*.—Subsection (c) of section 3484 provides that, for purposes of subsections (a), (b), and (d), married individuals are to be treated as one individual if, at the time the claim for refund is filed, they reasonably expect that they will file a joint return for the taxable year in which the claim is filed. If a husband and wife reasonably expect at the time a claim for refund is filed that they will file a joint income tax return for their current taxable year, they must compute a single refund allowance taking into account both the husband's and wife's income not subject to withholding under chapter 25, as well as the other factors on which the allowance is based. In such a case, they must file a joint claim and the single refund allowance will be the maximum amount which may be refunded with respect to tax withheld on both the husband and the wife.

(d) *Time for filing claim*.—Subsection (d) of section 3484 provides that not more than one claim may be filed under section 3484 by any individual during any quarter of his taxable year. The claim may be filed at any time during the quarter. A refund of tax deducted and

withheld on amounts received during a taxable year is to be made under this section only if claim therefor is filed on or before the last day of such taxable year. A claim filed during the first three quarters may include the tax withheld on amounts received during the quarter in which the claim is filed or during any prior quarter if no allowable claim for refund has been filed under section 3484 for such tax. Although no claim may be filed under section 3484 with respect to tax deducted and withheld on amounts received during the fourth quarter of an individual's taxable year, a claim may be filed during the fourth quarter with respect to tax withheld on amounts received during prior quarters to the extent not previously claimed. No claim may cover tax on amounts not yet received.

The claim for refund filed by an individual for the first quarter of his taxable year will contain a computation of his refund allowance, made in the manner provided in section 3484(b). Upon receipt of the claim, the Internal Revenue Service will establish a refund account for the individual. The Internal Revenue Service will mail to the individual a refund claim form for the second quarter, which will show the maximum amount which may be refunded to him based upon his refund allowance as computed by the Service from the facts stated on his first claim. If there are no changes requiring a recomputation of his refund allowance, the individual will so certify on the claim form and will specify the net amounts of interest, dividends, and patronage dividends, on which tax has been withheld under chapter 25, which he has received and which were not included on his prior claim. When the claim, properly signed, is returned to the Internal Revenue Service it will constitute his claim for refund of the tax withheld with respect to the net amounts specified and, to the extent that the amount of such tax does not exceed the individual's refund allowance, it will be promptly refunded to him. If the facts on which his refund allowance computation is based have changed, the individual must recompute his refund allowance on the form provided on the back of the claim. The amount of his refund may not exceed the amount of the new refund allowance thus determined. An individual is not required to recompute his refund allowance because of a change in his estimate of amounts (other than amounts on which tax is required to be deducted and withheld under ch. 25) which he reasonably expects to be includible in his gross income for the taxable year, unless his new estimate exceeds the prior estimate by more than \$100. If an individual chooses, he need not wait until he receives the claim form from the Internal Revenue Service, but may file a claim for refund under this section at any time during the quarter. If he does so, he may not file another claim during that quarter.

Procedures similar to those described in the preceding paragraph will be followed by the Internal Revenue Service and the individual for the third quarter.

It is anticipated that at the close of the year, the Internal Revenue Service will mail to each individual who files claims for refund under the above procedure a statement showing the total amount of refunds made to him during the year.

(e) *Individuals not eligible for refund.*—Subsection (e) of section 3484 provides that no claim for refund may be filed under this section by—

(1) any individual (other than an individual referred to in par. (2) or (3) of such subsec. (e)) unless, at the time the claim for refund is filed, he reasonably expects that his gross income for the taxable year will not exceed \$5,000;

(2) any married individual unless, at the time the claim for refund is filed, he reasonably expects that the aggregate of his gross income and that of his spouse for the taxable year will not exceed \$10,000;

(3) a head of a household (as defined in sec. 1(b)(2)) or a surviving spouse (as defined in sec. 2(b)) unless, at the time the claim for refund is filed, he reasonably expects that his gross income for the taxable year will not exceed \$10,000; or

(4) any child, unless, at the time the claim for refund is filed, he reasonably expects that no deduction would be allowed for him under section 151(e)(1)(B) for the taxable year of his parent (or parents) beginning with or within the calendar year in which the claim for refund is filed.

The application of section 3484 may be illustrated by the following example:

H and W, married individuals both over 65 and under 72, receive dividends of \$350 on January 1, April 1, July 1, and October 1, and interest of \$600 on April 1 and October 1. The interest is received by W and the dividends by H. H and W each expect to have \$1,000 of wages during the year. H and W expect to file a joint return for their taxable year ending on December 31, and will be allowed four exemptions.

(1) Allowance for exemptions ($4 \times \$600$)	\$2, 400
(2) Reasonable estimate of retirement income	2, 400
(3) Total, (1) and (2)	4, 800
(4) Less: Wages	2, 000
(5) Balance ((3) minus (4))	2, 800
(6) 22 percent of line (5)	616

	1st quarter	2d quarter	3d quarter
(a) Amount withheld, 20 percent	\$70	\$190	\$70
(b) Line (6)	616	616	616
(c) Refund for prior quarters		70	260
(d) Refund allowance ((b) - (c))	616	546	356
(e) Refund (smaller of (a) or (d))	70	190	70

The \$190 of tax deducted and withheld on the interest and dividends received on October 1 may be claimed as a credit under section 39 on H and W's joint income tax return for the year.

SECTION 3485. REFUND OF TAX TO STATES, TAX-EXEMPT ORGANIZATIONS, ETC.

Section 3485 provides that in the case of a person which is the United States, a State, a foreign government or international organization, an organization (other than a cooperative described in sec. 521) exempt from the income tax, or a foreign central bank of issue, if the amount withheld as tax with respect to dividends, interest, or patron-

age dividends received during any calendar quarter exceeds the credit, if any, claimed by and allowable to such person for that quarter under section 3505, which is added to the 1954 Code by subsection (d)(1) of section 19 of the bill, the excess (together with any such excess for any prior quarter of the same calendar year with respect to which no refund has been claimed and allowed under sec. 3485) is to be promptly refunded or credited to such person as an overpayment of the tax imposed by chapter 25. (For provisions excluding from withholding certain amounts paid to persons described in sec. 3485, see sec. 3452(b)(8) (relating to States, foreign governments, and international organizations), sec. 3452(c) (relating to the United States), and sec. 3483(a)(3) (relating to tax-exempt organizations).) The term "an organization (other than a cooperative described in sec. 521) exempt from the tax imposed by chapter 1" does not include a taxpayer merely because its deductions exceed its gross income.

Any person entitled under this section to claim a refund of tax withheld upon dividends, interest, or patronage dividends paid to it may file the claim immediately after the close of the calendar quarter in which they were received by it. The term "received" as used in this section includes constructive receipt. Therefore, in any case where a person exempt from income taxation constructively receives interest in any calendar quarter, the tax withheld upon that interest may be included in the claim filed for that quarter, even though the interest may not actually be collected until a subsequent quarter. A claim for refund under this section need not be filed for each calendar quarter in which dividends, interest, or patronage dividends are received. Thus, one claim may cover tax withheld on amounts received during more than one quarter. However, no claim in respect of tax withheld upon dividends, interest, or patronage dividends may be filed before the close of the calendar quarter in which such amounts are received.

If the person claiming a refund under this section for a calendar quarter also claims a credit under section 3505 for the same calendar quarter and the credit is allowable, the amount which may be refunded under section 3485 with respect to that quarter may not exceed the tax withheld with respect to dividends, interest, or patronage dividends received during that quarter, less the amount of such credit which is allowable under section 3505. However, the credit allowable under section 3505 is not required to be claimed by a person entitled to file a claim for refund under section 3485. Such person may pay its liability, if any, for the taxes imposed by chapters 21 and 24 for a calendar quarter and file a claim for refund of the total amount in respect of tax withheld upon dividends, interest, or patronage dividends received by it during that quarter.

In the case of a foreign central bank of issue, the provisions of section 3485 apply only to the tax under section 3451 deducted and withheld on interest on those obligations of the United States which are not held for, or used in connection with, the conduct of the bank's commercial banking functions or other commercial activities.

SECTION 3486. REFUND OF TAX TO CORPORATION

Section 3486 provides that in the case of a corporation (other than a corporation described in sec. 3485(a)), if the amount withheld as

tax on interest, dividends, or patronage dividends received during any quarter (other than the fourth quarter) of its taxable year exceeds the credit, if any, claimed by and allowable to the corporation for that quarter under section 3487 (which permits a corporation to offset the tax withheld under ch. 25 on amounts received by it against the tax it is required to withhold under ch. 25 on amounts paid by it), the excess (together with any such excess for any prior quarter of the same year with respect to which no refund has been claimed and allowed under sec. 3486) is to be promptly refunded to the corporation as an overpayment of tax. A claim for refund under section 3486 must be filed by the corporation after the close of the quarter to which it pertains and on or before the close of its taxable year. Any tax under chapter 25 withheld on amounts received by the corporation during the fourth quarter of its taxable year may be claimed as a credit under section 39 against its income tax liability for the year.

SECTION 3487. CREDIT FOR TAX WITHHELD ON CORPORATION

Section 3487(a) provides that tax deducted and withheld under chapter 25 on interest, dividends, or patronage dividends received by a corporation (other than a corporation described in sec. 3485(a)) during a taxable year will, to the extent not claimed and allowable as a credit or refund to the corporation during a prior quarter under section 3486, be allowed, under regulations prescribed by the Secretary of the Treasury or his delegate, as a credit against (but not in excess of) the tax for which the corporation is liable under chapter 25 in respect of dividends, interest, and patronage dividends paid by it during such year. The credit must be claimed on the quarterly return required under section 3481. For example, if a corporation received during the first quarter of its 1963 taxable year dividends of \$1,000 upon which tax was required to be withheld by the payor corporation under section 3461, the amount of the tax required to be withheld, or \$200, may be applied by the corporation as a credit against its liability for the tax which it is required to deduct and withhold upon any dividends or interest paid by it during the first or any later quarter of the same taxable year. If, in this example, the corporation paid dividends of \$750 during the first quarter on which it withheld \$150, it may claim a credit of \$150 against this \$150 which it would otherwise be required to remit to the Government. The company may file a claim under section 3486 for refund of the remaining \$50, or, if it does not file such a claim for refund, it may claim a credit under section 3487 for that amount against its liability for tax deducted and withheld by it under chapter 25 during a subsequent quarter of the same taxable year.

Section 3487(b) provides that if a dividend is treated as paid during the taxable year of a regulated investment company under section 855(a) or a real estate investment trust under section 858(a), such dividends may be considered for purposes of section 3487 as having been paid within the taxable year. Thus, the amount of tax withheld under chapter 25 with respect to dividends and interest received by a regulated investment company or a real estate investment trust during a taxable year may be allowed, under regulations prescribed by the Secretary of the Treasury or his delegate, as a credit against the tax which the company or trust is required to de-

duct and withhold upon the payment of any dividend declared and paid by it after the close of its taxable year, if the dividend is treated as having been paid during such taxable year under the provisions of section 855(a) or 858(a). Likewise, in the case of a personal holding company, the tax deducted and withheld on dividends and interest received by it during the taxable year may be allowed, under regulations prescribed by the Secretary or his delegate, as a credit under section 3487 against any tax under chapter 25 for which it is liable in respect of any dividend paid after the close of the taxable year and on or before the 15th day of the third month following the close of such taxable year, if such personal holding company elected under section 563(b) to have such dividend considered as paid during such taxable year. Comparable rules apply in the case of cooperatives.

Section 3487(c) provides that (to the extent and subject to such conditions as the Secretary or his delegate may provide in regulations) a credit under section 3487(a) may be allowed to one corporation for tax withheld on amounts received by another corporation during the same taxable year, if both corporations are members of an affiliated group which filed a consolidated return under chapter 6 of the 1954 Code for the preceding taxable year of the affiliated group.

SECTION 3488. OBLIGATION SOLD BETWEEN INTEREST-PAYMENT DATES

Section 3488 provides that, for purposes of any credit or refund authorized by chapter 25, the amount required to be deducted and withheld on the interest at the end of the interest-payment period will, in a case where the obligation is sold or exchanged between the interest-payment dates, be treated by the transferor and the transferee in the manner provided in section 39(c). Section 39(c) provides for the manner in which the tax shall be apportioned and the date on which the tax is treated as withheld from the transferor. If the transferor is eligible for a quarterly credit or refund under one of the provisions of chapter 25, he may claim the credit or refund of his allocable portion of the tax which will be deducted and withheld at the end of the interest-payment period as if such tax were actually withheld on the date of the transfer (since that is when it is treated as withheld under sec. 39(c)).

SECTION 3489. PRESUMPTION

The credits and refunds authorized by sections 39, 3505, and 3484 through 3487 are based on the amount of tax "deducted and withheld", and not on the amount "required to be deducted and withheld." In many cases recipients of amounts subject to withholding under chapter 25 will not receive statements from the withholding agent showing the amount deducted and withheld and, accordingly, will not have evidence in their possession to prove that the tax actually was deducted and withheld. Section 3489 provides that, for purposes of establishing that any person is entitled to a credit or refund under one of those sections, any tax under chapter 25 which was required to be deducted and withheld will, in the absence of evidence to the contrary, be presumed to have been deducted and withheld.

The presumption in section 3489 is a rebuttable one. Therefore, a recipient of interest, dividends, or patronage dividends who knows that the tax actually was not deducted and withheld is not entitled to claim a credit or refund of such tax. Furthermore, in any case where the Government can show that the tax for which credit or refund was claimed and allowed actually had not been deducted and withheld, the allowance of the credit or refund will be erroneous and the amount thereof may be recovered by the Government. However, no penalty will be imposed on a recipient of amounts with respect to which tax is required to be deducted and withheld under chapter 25 if such recipient in good faith, and in reliance on the presumption contained in section 3489, claimed a credit or refund of tax which later is shown not to have been deducted and withheld.

SECTION 3490. DEFINITIONS

The term "person" as used in chapter 25 includes the United States, a State, a foreign government, and an international organization. Definitions of certain of these terms are set forth in section 3490. For example, the term "State" is defined as including a State, the District of Columbia, a possession of the United States, any political subdivision of any of the foregoing, and any wholly owned agency or instrumentality of any one or more of the foregoing. See section 7701(a)(18) for definition of the term "international organization."

The term "nonresident alien individual" is defined as including an alien resident of Puerto Rico. Thus, for example, interest on deposits in a bank in the United States paid to an alien resident of Puerto Rico not engaged in trade or business within the United States is exempt from the provisions of section 3451 which provide for the deduction and withholding of tax on interest.

SECTION 19. WITHHOLDING OF INCOME TAX AT SOURCE ON INTEREST, DIVIDENDS, AND PATRONAGE DIVI- DENDS (Continued)

(b) *Credits against income tax for tax withheld.*—Subsection (b) of section 19 of the bill amends part IV of subchapter A of chapter 1 of the code (relating to credits against tax) by inserting after the new section 38 (added by sec. 2 of the bill) a new section 39. Subsection (b) amends section 584(c) (relating to the income of participants of common trust funds), by adding a new paragraph at the end thereof, and section 642(a) (relating to special rules for credits and deductions in the case of estates and trusts), by adding a new paragraph at the end thereof.

SECTION 39. TAX WITHHELD ON INTEREST, DIVIDENDS, AND PATRONAGE DIVIDENDS

(a) *General rule.*—The credit provided by section 39(a) is allowed to the taxpayer against his income tax liability for the taxable year in which the interest, dividend, or patronage dividend is received. The term "received" includes constructive receipt.

Under the withholding system incorporated in chapter 25, no receipt or statement of the amount of dividends, interest, or patronage

dividends paid to the recipient or the amount of tax withheld is required to be furnished by the payor of these amounts.

An appropriate schedule will be supplied on which a recipient of interest, dividends, or patronage dividends upon which tax is required to be withheld at the source may determine the proper amount to be reported in gross income and the amount to be claimed as a credit under section 39(a). The recipient will enter on the form (1) the net amount of interest, dividends, and patronage dividends received after withholding, (2) the amount withheld which, at the 20-percent withholding rate, will be determined by computing one-fourth of the net amount received, and (3) the sum of the amount actually received and the amount withheld. The total of the amount actually received and the amount withheld is the sum to be taken into account in computing gross income. The recipient will be allowed a credit against his tax liability for the amount determined as tax withheld at source.

The "grossing-up" method which will be incorporated on the form may be illustrated by the following example:

A, an individual, prepares his income tax returns on the cash receipts and disbursements method of accounting and on the basis of the calendar year. During the calendar year 1964, A receives the following items of income:

(1) Dividends:

(a) A net amount of \$800 from M Corporation representing dividends of \$1,000, less the tax withheld.

(b) A net distribution of \$130 from N Corporation, a regulated investment company, representing a capital gain dividend of \$50, and an ordinary dividend of \$100, less tax of \$20 withheld on the ordinary dividend.

(2) Interest:

(a) A net amount of \$64, representing \$80 of interest on two \$1,000 coupon bonds of P Corporation, less the tax withheld.

(b) A net amount of \$240, representing \$300 of interest upon the proceeds of a \$10,000 life insurance policy (which were left with the company under an agreement to pay interest), less the tax withheld, paid by the Q Insurance Company.

A will exclude from the "gross-up" computation the payment of \$50 received by him from the N Corporation, which represents a capital gain dividend, since a capital gain payment by a regulated investment company is excluded by section 3462(b)(2)(A) from withholding on dividends. With respect to dividends upon which tax is required to be withheld at source, he will include on the form the net amounts of \$800 received from M Corporation after withholding, and \$80 received from N Corporation after withholding. Thus, the total net amount of dividends, after withholding, included on the form will be \$880. A will then enter, as the tax withheld, one-fourth of this amount, or \$220. He will then enter \$1,100 as the total amount of dividends received which were subject to withholding.

In the "gross-up" of interest, A will enter \$64 on the form as interest received upon coupon bonds of P Corporation and \$240 as interest received from the Q Insurance Company. He will then enter the total net amount of interest received after withholding, or \$304. One-fourth of this amount, or \$76, will be entered on the form as the amount of tax withheld at the source. A will then add the amount of tax withheld and the total net amount of interest received after withholding

and enter the sum, or \$380, on the form as the total interest received. The total amounts of income tax withheld as shown on the form, \$220 on dividends plus \$76 on interest, or \$296, is the amount allowable to A as a credit under section 39(a) against his final tax liability. If any of the \$296 has been refunded to A during the year under section 3484, his credit under section 39(a) will be reduced by the amount so refunded.

(b) *Special rule for dependent children.*—Subsection (b) of section 39 provides that if a taxpayer for his taxable year is entitled to a deduction under section 151(e)(1)(B) for a child and the child had less than \$600 of gross income for the calendar year ending with or within the taxpayer's taxable year, and in addition the child had no wages during such calendar year which were subject to wage withholding under chapter 24, then the taxpayer-parent may, under regulations prescribed by the Secretary of the Treasury or his delegate, claim for the child against his (the parent's) tax the credit provided in section 39(a) for the tax withheld under chapter 25 on amounts paid to the child during such calendar year. However, the parent may claim the credit only if the child has not filed any claim for credit or refund of any portion of the tax deducted and withheld under chapter 25 with respect to such amounts.

(c) *Apportionment of credit.*—Subsection (c) of section 39 provides that where an obligation is sold or exchanged between interest-payment dates, the credit for the tax withheld on the interest paid at the end of the interest-payment period is apportioned between the transferor and the transferee. The part apportioned to the transferor is that part which is allocable to the portion of the interest-payment period which ends on the date of the sale or exchange and is treated as an amount withheld from the transferor on the date of the sale or exchange. The part apportioned to the transferee is that part which is allocable to the portion of the interest-payment period which begins on the day after the date of the sale or exchange. It is expected that, as a result of these apportionment rules, the purchaser of an obligation will pay the seller only four-fifths of the amount of accrued interest. For example, assume that on December 30, 1963, A sells to B a bond on which interest of \$100 is payable on March 31 and September 30 of each year. B pays A for the bond and \$40 (80 percent of the \$50 of interest then accrued) in cash for the accrued interest. Twenty dollars will be withheld on the \$100 interest payment when it is paid on March 31, 1964. One-half of the \$20, or \$10, is apportioned to A and is treated as though withheld from him on December 30, 1963, for purposes of the credit or refund provided in section 39(a).

(d) *Limitations.*—Subsection (d) of section 39 contains several provisions which prevent the allowance of duplicate credits for the same amount of tax. Among these provisions is one which prohibits the allowance of any credit under section 39 to a person described in section 3485 (States, tax-exempt organizations, etc.) for any amount for which a credit could have been allowed under section 3505 or for which a credit or refund is allowable under section 3485. Another provision prohibits the allowance of credit under section 39 to any person required to deduct and withhold tax under section 1441 or 1442 for any amount for which a credit is allowed to such person under section 1444(b).

SECTION 584. COMMON TRUST FUNDS

The amendment made to section 584(c) of the 1954 Code by section 19(b)(2) of the bill provides that, for purposes of any credit or refund provided in section 39 or 3505, or chapter 25, any tax deducted and withheld under chapter 25 on any amounts received during any taxable year by a common trust fund will, in accordance with regulations prescribed by the Secretary or his delegate, be considered as having been deducted and withheld proportionately from each participant in the common trust fund.

SECTION 642. ESTATES AND TRUSTS

The amendment made to section 642(a) of the 1954 Code by section 19(b)(3) of the bill provides that, for purposes of any credit or refund provided by section 39 or 3505, or by chapter 25, any tax deducted and withheld under chapter 25 on any amounts received by an estate or trust will, in accordance with regulations prescribed by the Secretary of the Treasury or his delegate, be considered as having been deducted and withheld from each beneficiary in an amount which, when added to the amounts paid, credited, or required to be distributed to him, equals the amounts which would have been paid, credited, or required to be distributed to him in the absence of chapter 25. Any tax under chapter 25 which is deducted and withheld on amounts received by the estate or trust are to be considered as withheld from the estate or trust, to the extent not considered as withheld from a beneficiary.

The estate or trust will "gross-up" the net dividends and interest received by it. This procedure will enable it to determine the distributions to the beneficiaries and the amount of the tax to be considered as withheld from each beneficiary. The beneficiary will not include any dividends or interest received from the estate or trust in the "grossing-up" schedule on his return. He will, instead, show in the schedule provided on the return for reporting income from estates or trusts the information supplied to him by the executor or trustee as to his share of the dividends and interest and of the withheld tax.

The following examples illustrate the application of these provisions:

Example (1).—A is the beneficiary of a trust the entire income of which is interest received from domestic corporations. Under the terms of the trust instrument, the entire net income is currently distributable to A. Both A and the trust report on the calendar year basis. During the taxable year, the trustee received from the corporations a net amount of \$8,000, representing interest of \$10,000 less tax withheld of \$2,000. The trust had expenses of \$1,000 during the year and distributes \$7,000 in cash to A. The trustee claims a deduction on the fiduciary return of \$9,000 under section 651 for income distributed to A, computed as follows:

Interest (grossed-up)	\$10, 000
Less expenses	1, 000
Distributable net income (sec. 643)	9, 000

Tax under chapter 25 in the amount of \$2,000 is considered as withheld from A, computed as follows:

Total amount of interest which would have been distributed to A in the absence of chapter 25	\$9, 000
Less amount paid to A	7, 000
Tax considered withheld from A	2, 000

The amount of interest received from the trust which is to be included in A's gross income is \$9,000. A is entitled to claim a credit of \$2,000 for the tax considered as withheld from him.

Example (2).—A, B, and C are beneficiaries of a trust which receives income in the form of interest and rentals from real estate. Under the terms of the trust instrument, all of the income derived from certain designated improved real estate is currently distributable to A, and all the income from other sources is currently distributable in equal portions to B and C. The income distributable to B and C includes interest from which tax was withheld. B and C are each entitled to one-half of the credit for the tax withheld since one-half of the tax is treated as having been withheld from each.

Example (3).—A and B are beneficiaries of a trust. B is a minor. Under the terms of the trust instrument, one-half of the net income of the trust is currently distributable to A and the other half is required to be accumulated by the trustee and added to corpus until B reaches the age of 21 years. Thereafter, the net income of the trust is currently distributable one-half to A and one-half to B. Both A and the trust report on the calendar year. During the taxable year the trust received the net amount of \$8,000 from domestic corporations, representing interest of \$10,000 less tax withheld of \$2,000. It had other income not subject to withholding, against which the trustee elected to offset the expenses of the trust. Interest of \$5,000 (\$4,000 in cash plus \$1,000 tax which is treated as withheld from A) may be distributed to A and deducted by the trust under section 661. A would include \$5,000 in his gross income and would be allowed a credit of \$1,000 for the tax which is treated as having been withheld from him. The trust would be entitled to a credit of \$1,000 of tax withheld which is attributable to the portion of interest (\$5,000) taxable to it as income not distributable to any beneficiary during the taxable year.

SECTION 19. WITHHOLDING OF INCOME TAX AT SOURCE ON INTEREST, DIVIDENDS, AND PARTONAGE DIVI- DENDS (Continued)

Technical amendments

Section 19(b)(4) of the bill makes several technical changes in the 1954 Code. It amends section 164(b)(1), relating to nondeductibility of certain taxes in computing taxable income for purposes of subtitle A of such code, by adding a new subparagraph (D) to provide that no deduction is to be allowed for tax withheld at source under chapter 25. Section 874(a) of the 1954 Code, which makes the filing of a return a

prerequisite to the allowance of deductions and credits to a nonresident alien, is amended to add the credit under section 39 to the credits for tax withheld at source which section 874(a) is not to be construed as denying. Section 1314(e) of the code, relating to nonapplicability of part II of subchapter Q of chapter 1 (mitigation of effect of limitations) to subtitle C taxes, is amended to show that subtitle C relates to collection of income tax at source, as well as to employment taxes. Section 6211 of the code, relating to the definition of a deficiency, is amended to include the credit provided by section 39 among the items, such as payments of estimated tax, which are to be disregarded in determining what constitutes "the tax imposed by chapter 1" and "the tax shown on the return" for purposes of such section.

(c) *Interest and dividends paid to nonresident aliens, etc.* Section 19(c) of the bill amends subchapter A of chapter 3 of the code by adding new material to section 1441 (relating to withholding of tax on nonresident aliens) and section 1442 (relating to withholding of tax on foreign corporations) and by adding a new section 1444.

The withholding rate applicable generally under existing sections 1441 and 1442 to interest and dividends is 30 percent, but this withholding rate has been modified by regulations to conform to the various lower tax rates, ranging all the way down to zero, provided by tax treaties.

Section 19(c)(1) of the bill amends sections 1441 and 1442 to provide that the tax required to be deducted and withheld under those sections will not by reason of the provisions of any treaty be less than 20 percent in the case of amounts described in section 3452(a) (relating to interest), section 3462(a) (relating to dividends), and section 3472(a) (relating to patronage dividends).

Section 19(c)(2) of the bill adds section 1444 to the code. Subsection (a) of the new section 1444 authorizes a nominee of a nonresident alien or of a foreign corporation, who is required to deduct and withhold tax under section 1441 or 1442 on interest, dividends, or patronage dividends transmitted by him to such beneficial owner, to notify a payor of such amounts to that effect. Thereafter such payor is not to deduct and withhold tax under chapter 25 on such amounts but is required to deduct and withhold tax under section 1441 or 1442 on the amounts paid to the nominee at the same rate as the payor would deduct and withhold if the payor were paying such amounts directly to the beneficial owner. If the nominee so notifies the payor, the nominee is relieved of responsibility for deducting and withholding tax under section 1441 or 1442.

In any case where tax under chapter 25 was deducted and withheld (or, in the case of a transfer between interest-payment dates, was treated as deducted and withheld under sec. 39(c)) on amounts received by a person who is under an obligation to deduct and withhold tax under section 1441 or 1442 on the same amounts, such person can, under section 1444(b), claim a credit for the chapter 25 tax deducted and withheld (or so treated) from him against his liability for payment of the tax which he is required to deduct and withhold under section 1441 or 1442. Section 1444(b) applies to all persons, and not just nominees, required to deduct and withhold under section 1441 or 1442.

(d) *Credit for States and tax-exempt organizations.*— Subsection (d) of section 19 of the bill adds a new section 3505 to chapter 26 of the code

(general provisions relating to employment taxes and income tax withheld at source).

The new section 3505 provides that, in the case of a person which is a State (as defined in sec. 3490(2) of the code) or which is an organization (other than a cooperative described in sec. 521 of the code) exempt from income tax, the tax deducted and withheld under chapter 25 with respect to amounts received by it during any calendar quarter is to be allowed, under regulations prescribed by the Secretary of the Treasury or his delegate, as a credit against (but not in excess of) such person's liability (after the adjustments, if any, provided for in secs. 6205(a) and 6413(a) of the code) for such quarter for the taxes imposed by chapter 21 (relating to the Federal Insurance Contributions Act) and by chapter 24 (relating to the collection of income tax at source on wages). This credit is to be allowed only if claim therefor is made, in accordance with such regulations, at the time of the filing of the return with respect to the taxes under chapter 21 and chapter 24 for such quarter.

Section 3505 permits a State or tax-exempt organization to offset the taxes withheld under chapter 25 on amounts received by it during a calendar quarter against its liability for the taxes imposed by chapter 21 and chapter 24 for the same calendar quarter. If the tax withheld from amounts paid to a State or tax-exempt organization exceeds the credit provided by section 3505, the excess will be refunded under the provisions of section 3425.

The term "received" as used in section 3505 includes constructive receipt. Thus, in the case of interest constructively received in a calendar quarter, the tax withheld upon such interest may be claimed as a credit, even though the interest is not actually collected until a subsequent quarter.

The credit provided for in section 3505 may be claimed only with respect to tax deducted and withheld on amounts received during a calendar quarter. If tax withheld upon amounts received during a calendar quarter is not claimed as a credit under section 3505 against taxes due under chapter 21 and chapter 24 for such quarter, no credit may thereafter be claimed for such tax under section 3505. However, a refund may be claimed for such tax under section 3425. The credit provided by section 3505 may not exceed the liability (after any adjustment made under sec. 6205(a) or 6413(a)) of the State or tax-exempt organization for the calendar quarter for the taxes imposed by chapter 21 and chapter 24.

Subsection (d)(2) of section 19 of the bill amends section 3502 of the code by adding a new subsection (e) therein which provides that the tax deducted and withheld under chapter 25 is not to be allowed as a deduction in computing taxable income under subtitle A either to the person deducting and withholding the tax or to the recipient of the amounts subject to withholding.

(e, Other technical amendments. Subsection (e) of section 19 of the bill makes several technical amendments to subtitle F of the code which are necessitated by the other provisions of section 19 of the bill.

Declaration of estimated income tax by individuals: Section 19(e)(1) of the bill amends section 6015 of the 1954 Code (relating to declarations of estimated income tax by individuals) to take into account tax withheld under chapter 25. Section 6015 now provides that a declaration of estimated tax is to be filed for the taxable year

if (1) the gross income for such taxable year can reasonably be expected to exceed certain specified amounts, or (2) the gross income for the taxable year from sources other than wages subject to withholding can reasonably be expected to exceed \$200. Section 6015, as amended, will change the latter requirement so as to require the filing of a declaration if the gross income from sources other than wages, interest, dividends, or patronage dividends subject to withholding can reasonably be expected to exceed \$200.

Adjustment of tax (underpayments): Section 19(e)(2) of the bill amends section 6205 of the code to extend to tax deducted and withheld under chapter 25 the special rules for adjustment of underpayments of tax now applicable to tax deducted and withheld on wages. Under these rules, as revised, if less than the correct amount of tax is paid or deducted with respect to any remuneration, interest, dividends, or other amounts, proper adjustments are to be made, without interest, in such manner and at such times as the Secretary of the Treasury or his delegate may by regulations prescribe. If the underpayment of tax cannot be adjusted, it is to be assessed and collected, in such manner and at such times (subject to the statute of limitations properly applicable thereto) as may be prescribed by regulations.

Use of Government depositaries: Section 19(e)(3) of the bill amends section 6302(c), relating to the use of Government depositaries, to provide that, in the case of tax required to be deducted and withheld under chapter 25 (relating to collection of income tax at source on interest, dividends, and patronage dividends), deposit of the tax in a Government depositary may not be required under section 6302(c) at any time before the last day prescribed in section 3481 for payment of the tax; that is, the last day of the first month following the close of the quarter in which the tax was deducted and withheld.

Excessive withholding treated as overpayment: Section 19(e)(4) of the bill amends section 6401(b) of the code, relating to excessive withholding. Section 6401(b) now provides that if the amount allowable as a credit under section 31 (relating to credit for tax withheld at the source on wages under ch. 24) exceeds the taxes imposed by chapter 1 against which such credit is allowable, the amount of the excess is considered an overpayment. Such section is amended to provide that if the amounts allowable as credits under section 31 and section 39 (relating to credit for tax withheld under ch. 25) exceed the taxes imposed by chapter 1 against which such credits are allowable, the amount of such excess is to be considered an overpayment.

Adjustment of tax (overpayments): Section 19(e)(5) of the bill amends section 6413 of the code to extend to tax deducted and withheld under chapter 25 the special rules for adjustment of overpayments of tax now applicable to tax deducted and withheld on wages. Under these rules, as revised, if more than the correct amount of tax is paid or deducted with respect to any remuneration, interest, dividends, or other amounts, proper adjustments are to be made, without interest, in such manner and at such times as the Secretary of the Treasury or his delegate may by regulations prescribe. If the overpayment of tax cannot be adjusted, it is to be refunded in such manner and at such times (subject to the statute of limitations properly applicable thereto) as may be prescribed by regulations.

Overpayment not deducted and withheld: Section 19(e)(6) of the bill amends section 6414 of the code, relating to refunds or credits to

employers or withholding agents, so as to extend the restrictions on such credits or refunds to amounts withheld under chapter 25.

Presumptions as to date of payment: Section 19(e)(7) of the bill amends section 6513(b) of the code, which relates to the time tax withheld on wages and estimated income tax payments are deemed to have been paid for purposes of determining the time within which an allowable claim for credit or refund must be filed. New sentences are added to section 6513(b) to provide that the amount allowable as a credit under section 39 (relating to credit for tax withheld under ch. 25), or as a credit or refund under chapter 25 (other than sec. 3487), will, in respect of the person entitled to such credit or refund, be deemed to have been paid by him on the last day prescribed for filing the return under section 6012 (determined without regard to any extension of time for filing such return) for his taxable year in which the amount subject to withholding under chapter 25 is received by him. As used in the amendment to section 6513(b), the term "taxable year in which the amount subject to withholding under chapter 25 is received by him" means in a case where an amount subject to withholding is required to be included in the gross income of a taxpayer even though not actually distributed to him, the taxable year in which such amount is includible in the taxpayer's gross income. The new sentences also provide special rules as to the time tax is considered paid by persons (such as States, tax-exempt organizations, etc.) not required to file returns, and by a parent claiming credit for tax withheld on amounts received by his child. These rules will, by reason of a reference to section 6513 contained in section 6611, also be applicable in determining when interest will be paid on overpayments attributable to withholding under chapter 25.

Failure to pay estimated income tax: Section 19(e)(8) of the bill amends section 6654 of the code, relating to failure by an individual to pay estimated income tax, to provide in respect of the credit under section 39 (relating to credit for tax withheld under ch. 25) the same treatment as is now provided in respect of the credit under section 31 (relating to credit for tax withheld on wages). As amended, section 6654(e) provides that the estimated tax will be computed without any reduction for the amount which the individual estimates as his credit under section 31 or section 39. It further provides that the amount of credit allowed under sections 31 and 39 for the taxable year will be deemed a payment of estimated tax, and that an equal part of such amount shall be deemed paid on each installment date for such taxable year, unless the taxpayer establishes the dates on which all amounts were actually withheld (or in the case of an amount described in sec. 39(c)(1) the date when the amount is treated as withheld), in which case the amounts so withheld will be deemed payments of estimated tax on the dates on which such amounts were actually withheld (or so treated as withheld). Section 6654(f), as amended by section 19(e)(8) of the bill, provides that for purposes of determining the amount of the underpayment under section 6654(b) and the applicability of the exceptions contained in section 6654(d), the term "tax" means the tax imposed by chapter 1 reduced by the credits against tax allowed by part IV of subchapter A of chapter 1, other than the credits against tax provided by sections 31 and 39.

Section 19(e)(8) of the bill also amends section 6655 of the code, relating to failure by a corporation to pay estimated income tax, to

provide that the estimated tax is to be computed without any reduction for the amount which the corporation estimates as its credit under section 39, that the credit allowed the corporation under section 39 for the taxable year is to be deemed a payment of estimated tax, an equal part of which is to be deemed paid on each installment date for the taxable year, unless the dates on which the tax was actually withheld (or in the case of an amount described in sec. 39(c)(1) the date when the amount is treated as withheld) are established, and that, for purposes of determining the amount of the underpayment under section 6655(b) and the applicability of the exceptions contained in section 6655(d), the term "tax" means the tax without any reduction for the amount which the corporation estimates as its credit under section 39.

Penalty for filing fraudulent exemption certificate or failure to give required notice: Section 19(e)(9) of the bill amends section 7205 of the code to provide a penalty for the willful filing of an exemption certificate under section 3483 which is known by the person filing it to be false or fraudulent as to any material matter. The penalty is a fine of not more than \$500, imprisonment for not more than 1 year, or both. A similar penalty is provided in respect of the willful failure of an organization which has lost its tax-exempt status to give notice of that fact, as required by section 3483(a)(3)(B), to each payor with which it has filed an exemption certificate.

Separate accounting for collected taxes: Section 19(e)(10) of the bill amends section 7215, which provides a penalty for failure to comply with any provision of section 7512(b), relating to separate accounting for the taxes imposed by subtitle C or by chapter 33. Section 7215 provides that the penalty is not to apply to any person who shows that his failure to comply was due to circumstances beyond his control. The section also provides however, that a lack of funds existing immediately after the payment of wages (whether or not created by the payment of such wages) will not be considered to be circumstances beyond the control of a person. Section 19(e)(10) of the bill amends this latter provision so that it will apply not only to wages but also to amounts subject to withholding under chapter 25.

Definition of withholding agent: Section 19(e)(11) of the bill makes a conforming amendment to section 7701(a)(16) of the code, relating to the definition of "withholding agent," by adding references therein to sections 3451, 3461, and 3471.

(f) *Effective dates.*—Subsection (f) of section 19 of the bill provides effective dates for such section 19. Paragraph (1) of subsection (f) makes the provisions of the bill generally applicable to interest and dividends paid on or after January 1, 1963. Special rules are provided in paragraph (2) with respect to certain transferable obligations and patronage dividends. Subparagraph (A) of paragraph (2) provides that in the case of interest on transferable obligations such as bonds, debentures, notes, certificates, or other evidences of indebtedness issued by a corporation, and in the case of interest on transferable obligations of the United States, the provisions of the bill are to apply only to such interest paid with respect to interest-payment periods commencing on or after January 1, 1963. Subparagraph (B) of paragraph (2) provides the effective date as to amounts described in section 3472. Such amounts paid on or after January 1, 1963, with respect to patronage occurring on or after the first day of the first

taxable year of the cooperative beginning on or after January 1, 1963, are to be subject to the withholding tax; whereas, amounts paid on or after January 1, 1963, with respect to patronage occurring before the first day of the first taxable year of the cooperative beginning on or after January 1, 1963, are not to be subject to the withholding tax.

SECTION 20. INFORMATION WITH RESPECT TO CERTAIN FOREIGN ENTITIES

(a) *Information to be furnished by individuals, domestic corporations, etc., with respect to certain foreign corporations.*—Subsection (a) of section 20 of the bill amends section 6038 of the 1954 Code. Section 6038(a)(1) requires every United States person to furnish the information required by such section with respect to any foreign corporation which such person controls (as defined in section 6038(d), as amended by the bill). Under existing law, the obligation to furnish information is imposed only on domestic corporations and only with respect to controlled foreign corporations and foreign subsidiaries of such controlled foreign corporations.

The requirements as to the information to be furnished are not changed except that (1) because of the redefinition of “control” including the addition of most of the constructive ownership rules of section 318(a) of the 1954 Code, there will be an increase in the number of persons whose transactions with controlled corporations must be reported, and (2) the Secretary of the Treasury or his delegate is authorized to require the furnishing of any other information which is similar or related in nature to that specified in paragraph (1) of section 6038(a) as amended by the bill.

Under the amendment made by section 20(a) of the bill, the period for which information is to be furnished under section 6038(a)(2) is modified to provide that, in all cases, such period is that ending with or within the United States person’s taxable year. The amendment does not change the period with respect to a first-tier foreign corporation. However, with respect to a foreign subsidiary of such corporation, the period is changed from that ending with or within the first-tier corporation’s annual accounting period to that ending with or within the United States person’s taxable year. Thus, the effect of the amendment will be to obtain information which is more current from the sub-subsidiary.

Section 6038(a)(3), as amended by the bill, is the same as existing law. It provides that no information will be required to be furnished under section 6038(a) with respect to any foreign corporation for any annual accounting period unless such information was required to be furnished under regulations in effect on the first day of such annual accounting period.

Section 6038(b), which sets forth the penalty for failure to file the required information within the prescribed time, is amended to provide that the reduction in foreign taxes paid or deemed paid now provided by section 6038(b) will occur in applying section 901 as well as section 902, although it will not occur under both sections with respect to the same tax. In addition, the reduction is to apply in respect of taxes deemed paid under section 957 of the code (added by sec. 13(a) of

the bill). Also, the penalty provided by section 6038(b), as amended by the bill, is extended to other than corporate taxpayers.

The reduction in foreign taxes paid or deemed paid for failure to file the required information within the prescribed time is not to apply, however, in computing accumulated profits in excess of income, war profits, and excess profits taxes under section 902 (a) and (b) of the code (relating to foreign tax credit for a corporate stockholder of a foreign corporation).

The effects of section 6038(b), as amended by the bill, on section 78 as added by section 11 of the bill, and on the computation of a foreign tax credit under section 902(a), may be illustrated by the following example involving corporation A, a domestic corporation which owns 100 percent of the voting stock of corporation B, a foreign corporation. It is assumed the dividend from corporation B is the only dividend received from a foreign corporation by corporation A.

(i) Gains, profits, and income of corporation B.....	\$100, 000
(ii) Foreign tax paid by corporation B with respect to such gains, profits, and income.....	40, 000
(iii) Reduction of foreign tax paid by corporation B, resulting from corporation A's failure to file information with respect to corporation B as required by section 6038(a): 90-day failure to file, 10 percent reduction; additional 3 months failure to file, 5 percent reduction; total reduction, 15 percent. $\$40,000 \times 15$ percent.....	6, 000
(iv) Foreign tax paid by corporation B after section 6038(b)(1)(B) reduction.....	34, 000
(v) Dividend paid by corporation B to corporation A.....	45, 000
(vi) Accumulated profits of corporation B computed without reduction for foreign taxes (sec. 902(c)).....	100, 000
(vii) Accumulated profits of corporation B reduced by foreign taxes (sec. 902(a)).....	60, 000
(viii) Corporation A is deemed to have paid the same proportion of the total tax paid by corporation B, after reduction, as dividends, without regard to section 78, bear to accumulated profits in excess of taxes, without reduction by reason of sec. 6038(b)(1)(B): $\$34,000 \times \$45,000 \div \$60,000$	25, 500

Corporation A must include \$25,500 in gross income as a dividend under section 78. The above example illustrates with respect to reductions in foreign taxes paid by the foreign corporation that (1) such reductions are taken into account in determining the amount included in gross income as foreign taxes deemed paid under section 78, as added by section 11 of the bill, and (2) such reductions are not taken into account in computing accumulated profits for purposes of determining the amount of foreign taxes deemed paid with respect to a particular dividend.

Section 6038(c), as amended by the bill, provides that where two or more persons are required to furnish information with respect to the same controlled foreign corporation for the same period, the Secretary of the Treasury or his delegate may prescribe that such information will be required only from one person. To the extent practicable, the Secretary's determination is to be based on actual ownership of stock (as distinguished from constructive ownership).

Section 6038(d) defines "control" as the possession of more than 50 percent of the combined voting power, or of the value, of all classes of stock. A person in control of a corporation which, in turn, owns more than 50 percent of the combined voting power, or of the value, of all classes of stock of another corporation is also treated as in

control of such other corporation. Thus, for example, in the case of a chain of corporations consisting of corporation M, owning 51 percent of the voting stock in corporation N, owning, in turn, 51 percent of the voting stock in corporation O, owning, in turn, 51 percent of the voting stock in corporation P; corporation P is controlled by corporation M. The rules of section 318(a) apply in determining stock ownership, except that the rule which requires ownership of 50 percent of the stock of a corporation before stock owned by such corporation is attributed to its stockholders does not apply. The constructive ownership rules apply in determining control of domestic and foreign corporations but not in determining, under section 6038(a)(1)(D)(iii), whether a transaction is with a corporation 10 percent or more of the value of any class of stock of which is owned by a United States person.

The amended section 6038(d) defines the "annual accounting period" of a foreign corporation as the annual period on the basis of which such corporation regularly computes its income in keeping its books.

Section 6038(e) provides cross-references to sections 7203 and 7701(a)(30), respectively, for provisions relating to penalties for violations of section 6038, and for the definition of the term "United States person".

(b) *Information as to organization or reorganization of foreign corporations and as to acquisitions of their stock.*—Subsection (b) of section 20 of the bill amends section 6046 of the 1954 Code.

Paragraph (1) of section 6046(a), as amended by the bill, requires an information return from each United States citizen or resident who, on January 1, 1963, is an officer or director of a foreign corporation or who becomes such an officer or director at any time after that date.

Paragraph (2) of section 6046(a) requires each United States person to file an information return under any of the following circumstances:

(1) He owns 5 percent or more in value of the stock of a foreign corporation on January 1, 1963.

(2) He owns stock of a foreign corporation on January 1, 1963, which has a value of less than 5 percent of the value of the stock of such corporation, or owns no stock on January 1, 1963, and thereafter acquires stock which, when added to the stock held on January 1, 1963, if any, has a value equal to 5 percent or more of the value of the stock of such foreign corporation.

(3) He acquires an additional 5 percent or more in value of the stock of a foreign corporation.

Paragraph (3) of section 6046(a) requires each person who becomes a United States person after January 1, 1963, while owning 5 percent or more in value of the stock of a foreign corporation to file an information return.

Example.—A, a United States person, who on January 1, 1963, owns 2 percent in value of the stock of foreign corporation M is not required to file an information return under section 6046. However, when he acquires, on April 1, 1963, an additional block of stock consisting of 4 percent in value of the stock of such corporation, he is required by subparagraph (A) of section 6046(a)(2) to make an information return with respect to corporation M. If, on December 31, 1964, he acquires a 6 percent block of stock in addition to that already owned, he is required to file a return under subparagraph (B) of section 6046(a)(2). He is not required to report when, on May 1, 1965, he acquires an

additional 3 percent block of stock, but he is required to report under subparagraph (B) when, on November 30, 1965, he acquires a 4 percent block of stock because the last two blocks of stock total more than 5 percent.

Subsection (b) of section 6046, as amended by the bill, is the same as existing law. It provides that the information returns required by subsection (a) of section 6046 shall be in such form and shall set forth, in respect of the foreign corporation, such information as the Secretary of the Treasury or his delegate prescribes by forms or regulations as necessary for carrying out the provisions of the income tax laws.

Subsection (c) of section 6046 is amended by omitting the definition of "United States shareholder". The term "United States person", as used in sections 6038 and 6046, as amended by the bill, has the same substantive meaning as the term "United States shareholder" in existing section 6046.

Subsection (d) of section 6046, as amended by the bill, provides a limitation on the time for filing a return required by subsection (a) of such section. Such return must be filed on or before the 90th day after the day on which, under any provision of section 6046(a), the United States citizen, resident, or person becomes liable to file such return.

Subsection (e) of section 6046, as amended by the bill, is a cross reference to section 7203, relating to willful failure to file a return, supply information, or pay tax.

(c) *Civil penalty for failure to file return.*—Subsection (c) of section 20 of the bill amends subchapter B of chapter 68 (relating to assessable penalties) by adding new section 6678.

Subsection (a) of section 6678, similar in purpose to section 6677 (relating to failure to file information returns with respect to certain foreign trusts) as added by section 9(g) of the bill, provides that in addition to any criminal penalty provided by law, any person required to file a return under section 6046 who fails to file such return at the time provided in section 6046, or who files a return which does not show the information required pursuant to such section, must pay a penalty of \$1,000, unless it is shown that such failure is due to reasonable cause.

Subsection (b) of section 6678 provides that subchapter B of chapter 63 (relating to deficiency procedure for income, estate, and gift taxes) is inapplicable in respect of the assessment or collection of any penalty imposed by subsection (a).

(d) *Technical amendments.*—Subsection (d) of section 20 of the bill contains technical amendments adding a cross reference to section 318 of the Code and conforming the appropriate table of sections to the change in the heading of section 6046.

(e) *Effective date.*—Under subsection (e) of section 20 of the bill, section 6038 of the code as amended by the bill is to apply with respect to annual accounting periods of foreign corporations beginning after December 31, 1962, and section 6046 of the code as amended by the bill is to take effect on January 1, 1963. Under subsection (e)(1), existing section 6038 will continue to apply in respect of a foreign corporation or foreign subsidiary whose annual accounting period begins before January 1, 1963. For example, assume that D, a domestic corporation, has a taxable year beginning July 1, 1963, and

ending June 30, 1964. F, a foreign corporation controlled by D, has an annual accounting period beginning January 1, 1963, and ending December 31, 1963. FS, a foreign subsidiary of F, has an annual accounting period beginning April 1, 1962, and ending March 31, 1963. Under the effective date provision, information with respect to FS's annual accounting period beginning April 1, 1962, and ending March 31, 1963, is to be furnished under existing law, and information with respect to F's annual accounting period beginning January 1, 1963, and ending December 31, 1963, is to be furnished under section 6038 as amended by the bill.

SECTION 21. TREATIES

Section 7852(d) of the 1954 Code provides that no provision of the 1954 Code shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on August 16, 1954. Section 21 of the bill provides that section 7852(d) shall not apply in respect of any amendment made by the bill, thus making it clear that in the event there is any conflict with any treaty provision (whether or not such provision was in effect on Aug. 16, 1954) the provisions of the bill are to govern.

SEPARATE VIEWS OF THE REPUBLICANS ON
H.R. 10650

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SEPARATE VIEWS OF THE REPUBLICANS ON H.R. 10650

GENERAL STATEMENT

H.R. 10650 violates the concepts of sound tax policy and fiscal responsibility. By itself, the bill's \$1.5 billion loss in revenue insures that the Kennedy budget's proposed \$500 million surplus for fiscal 1963 will become a \$1 billion deficit. This conscious creation of a deficit flies in the face of the President's warning in his budget message that "to plan a deficit under such circumstances would increase the risk of inflationary pressures, damaging alike to our domestic economy and to our international balance of payments."

The administration's approach to tax reform cannot provide this Nation with a tax structure that will insure continued healthy and noninflationary economic growth. Further, this approach can only serve to pile complexity upon complexity for the citizen who must cope with a tax code already much too complex. The answer to our tax problems will not be found in patchwork legislation. If the huge revenue loss in this bill were to result in sound, growth-inducing tax policy, Congress might be justified in accepting the risks involved. This bill, however, does not represent sound tax policy. It represents precisely the opposite.

Our concern centers on its three major provisions:

(1) The so-called "investment credit" perverts the tax laws into a \$2 billion annual subsidy to one segment of the business community and constitutes nothing less than a discriminatory "loophole" which will have to be dealt with by a future Congress (sec. 2).

(2) To defray part of the cost of the investment subsidy, 20 percent will be withheld on dividends and interest, regardless of whether or not money is actually owed to the Government. To the extent that part of the investment subsidy is paid for by this departure from our voluntary compliance system, a large share will be money to which the Government may not be entitled (sec. 19).

(3) The proposed treatment of income earned abroad by a "controlled" foreign corporation discards the long-established concept that our economy, our national security, and the growth and independence of the free world depends on the expansion of American foreign trade and American business overseas (sec. 13).

The so-called "investment credit" (sec. 2) and taxation of the undistributed income of the "controlled" foreign corporation (sec. 13) are intended, not for the purpose of raising revenue, but to direct and control the future conduct of American business both at home and abroad. This is the "carrot and stick" method of Government regulation of business.

The "investment credit" is nothing more than a tax "gimmick." It is outright annual subsidy of \$2 billion to a segment of the business

economy, which business as a whole neither seeks nor wants. It ignores the service industries, and the distribution and retail segments of our economy. It favors the large, and it penalizes the small. For example, one large company and its affiliates will receive a subsidy of more than \$100 million, which the company is not seeking and does not want. This is the equivalent of one-sixth of the revenue that withholding, with its inconvenience to many millions of small investors, is supposed to produce.

Withholding on dividends and interest will be an administrative monstrosity, as was apparent by the difficulty which the committee had in adopting any withholding procedure. The provision for individual exemption certificates, adopted as a "last minute" measure, merely compounds the problem. The withholding provision now has all the inequities of massive "overwithholding" as well as the administrative burden on both the payer and the Treasury of multitudinous exemption certificates. It is conservatively estimated that there will be more than 500 million dividend and interest accounts which are affected by the withholding provision. At least one-third of these will involve withholding of nominal amounts, probably less than \$1 per year. The qualification for filing an exemption certificate is so restrictive that many individuals will undoubtedly be hesitant to file, even though they may owe no tax.

The Government is investing millions of dollars in "computers" for processing information returns. The individual taxpayer is paying for that equipment. Indirectly, the individual taxpayer is also paying for the administrative expense which will be incurred by the payer in complying with these withholding procedures. With all of this, the individual must still be put to the unnecessary trouble and expense of annually filing exemption certificates and/or claims for refund for nominal amounts in order to avoid the collection of a tax which is not due. Instead, we urge that the Government be required to utilize the information returns procedure, the newly authorized taxpayer identification numbers, and the data-processing equipment, to save the individual from such inconvenience and expense.

With respect to the treatment of income earned abroad, we have in the past proceeded on the theory that the expansion of American foreign trade and American business overseas was indispensable to our national defense, to our domestic economy, and to the growth and freedom of the free world. In contrast to this policy, the bill seeks to build a "Berlin wall" in the tax laws to keep the American businessman at home. The bill would deny to American business the right enjoyed by its foreign competitors to go into any area of the free world where there might be a market, a source of raw materials, or the workers needed to make the business a success. The policy of this bill is a policy of "internationalism" as to foreign-owned business and "isolationism" as to American-owned business.

DISCUSSION OF CREDIT FOR INVESTMENT IN DEPRECIABLE PROPERTY

BILL FORESHADOWS \$2.5 BILLION BUDGET DEFICIT

For the fiscal year 1963, it has been estimated that the investment credit will result in a revenue loss of \$1.8 billion, without taking into account any increase in the level of investment. If there is even a

minimum "incentive"—and "incentive" is the administration's justification for the proposal—the revenue loss will be more than \$2 billion. Offsetting this, the estimated revenue provisions of the bill will produce only \$250 million in fiscal 1963, mainly from withholding. The enactment of this bill will result in a loss of more than \$1.5 billion in the Federal revenues for fiscal 1963. The budget as presented by the President for the fiscal year 1963 showed a surplus of less than \$500 million. It can readily be seen that this bill taken by itself will convert that speculative surplus in the President's budget to a deficit of at least \$1 billion.

Even on a "full year effect" basis, the bill produces a revenue loss of \$775 million—and this has been heralded as only the "first step" in the Kennedy administration's tax "reform" program. The Treasury's proposed administrative revision of the depreciation schedules, soon to be released, is reported to involve a revenue loss of an additional \$1.5 to \$2 billion. When this is added to the cost of this bill, the net result will be a deficit in fiscal 1963 of \$2.5 billion.

BUSINESS AND LABOR OPPOSE INVESTMENT CREDIT

The investment credit was initially proposed by the Kennedy administration to stimulate new "productive" investment which would not otherwise be undertaken. In this bill, however, the credit was extended to all investment in specific types of property, whether or not induced by the credit. It is also extended to all manufacturing industries, hotels and motels, public carriers, utilities, farming, and any other business in which tangible personal property is used. Although the hotels and motels, and certain regulated public utilities were excluded in the original proposal, the committee extended the credit to them, but at a reduced rate in the case of the utilities.

In the hearings on the tentative bill the support for the investment credit consisted almost exclusively of administration witnesses from the Departments of Treasury, Labor, and Commerce. The investment credit approach has been opposed by almost every major organization appearing before the committee. A representative list of those opposing the credit included the following:

- Aerospace Industries Association.
- AFL-CIO.
- American Institute of Certified Public Accountants.
- American Machine Tool Distributors Association.
- American Meat Institute.
- Brooklyn Chamber of Commerce.
- Chamber of Commerce of the United States of America.
- Committee for Economic Development.
- Controllers Institute of America.
- Copper & Brass Research Association.
- Council of State Chambers of Commerce.
- Edison Electric Institute.
- Illinois State Chamber of Commerce.
- International Union of Mine, Mill & Smelter Workers.
- Lithographers & Printers National Association.
- Machinery Dealers National Association.
- National Association of Manufacturers.
- National Small Business Men's Association.

Rubber Manufacturers Association, Inc.
 Southern States Industrial Council.
 Transportation Association of America.
 U.S. Junior Chamber of Commerce.
 United Shareholders of America.
 Virginia Manufacturers Association.
 Wisconsin Manufacturers Association.

It is a situation unique in the history of this committee, that the committee should insist on providing a tax benefit so overwhelmingly opposed by all segments of our society.

INVESTMENT CREDIT WILL NOT STIMULATE SOUND INVESTMENT

The investment credit is not a sound "incentive." A recent survey by the Wall Street Journal, the results of which were published on February 8, 1962, disclosed that of 68 companies surveyed, only 1 believed that the credit would have a significant effect on major expansion programs. There is no relationship between the revenue loss attributable to the credit and the additional expansion which the credit might produce.

On February 23, 1962, the AFL-CIO Executive Council, meeting at Bal Harbour, Fla., issued the following statement:

The AFL-CIO has strongly and vigorously opposed the investment tax credit proposal as one that would grant a major tax windfall to corporations *without accomplishing its basic purpose of increasing the efficiency of American productive capacity.* [Italic supplied.]

This conclusion was supported by an array of witnesses in recent hearings before the Joint Economic Committee.

INVESTMENT CREDIT IS A TRUE "LOOPHOLE"

At a time when the Kennedy administration spokesmen are attacking various so-called "loopholes" in the revenue laws, the provision represents a "new frontier" in the field of special tax concessions.

The investment credit will not be reflected in the accounting for renegotiation, cost-plus-fixed-fee contracts, and redeterminable price contracts. In other words, the full cost of the item will be charged to the Government contract, without any provision for recapture of the investment credit in the case of excessive profits.

The provision grants a credit to the taxpayer, irrespective either of need or of prior obligation to make the investment. For example, an investment credit is granted for investment in U.S.-flag vessels although many U.S.-flag operators are already obligated to replace their older vessels and have funds set aside for that purpose. The Government already subsidizes 50 percent of the construction cost. The bill provides an "incentive" of 8 percent more.

The provision permitting either the lessor or the lessee of property to utilize the credit, at the election of the lessor, creates a further "loophole." A deduction or credit of this magnitude should not be left for "trading" as between taxpayers. In the case of leasing companies and other predominantly leasing businesses (i.e., computer rentals), the investment credit is tantamount to a 50-percent tax

reduction, or an effective tax rate of 26 percent. The lessee is the user of the equipment, whose business is affected by competition. It is the lessee who in fact ultimately pays for the equipment. Therefore, if anyone is to receive a credit for leased equipment, it should be the lessee.

Many lessors of equipment are, in substance, nothing more than finance companies. In some respects these lessors compete with the banks, insurance companies, and other lending institutions. The bill gives these types of institutions a tremendous advantage over the more conventional financing institutions.

INVESTMENT CREDIT IS INHERENTLY DISCRIMINATORY

An "incentive" approach to taxation is wrong. What constitutes an incentive to one taxpayer is a penalty to another taxpayer. The investment credit approach penalizes taxpayers who have expanded and modernized without having to rely upon any tax inducement. The allowance of a credit discriminates in favor of the taxpayers in a particular industry who have not kept abreast of technological developments within that industry. The effect is to subsidize a company which has lagged behind its competitors in plant modernization, at the expense of those competitors.

The investment credit discriminates *in favor* of transient hotels and motels and *against* residential hotels, apartments, and other rental housing. In fact, in the tax treatment of any investment which does not qualify for the investment credit, there is unwarranted discrimination.

An investment credit is provided for all qualified investments. Opinions may vary with respect to the extent to which the credit will act as a real incentive in increasing investment over the amount which would have been invested under existing law. However, a credit as high as 8 percent for all qualified investments is an excessive price to pay for the relatively lesser amount which could be attributed solely to the credit.

The graduation of the credit based upon the useful life of the asset recognizes a basic inequity from the standpoint of the investor. In dealing with assets having a useful life of 8 years and over—and most machinery and equipment would fall in that category—an investor in assets having a 10-year life would turn over his money twice as fast as an investor in assets having a 20-year life. Thus, on the same dollar investment over the same period of time the investor in the 10-year assets would receive a credit that was 200 percent of the credit that would accrue to the investor in the 20-year assets. However, in the case of public utilities, where the useful life is usually 20 years and over, the credit is cut in half.

Accelerated depreciation operates more nearly in relationship to increased investment than the investment credit. In the case of the investment credit, a taxpayer receives a benefit each year irrespective whether his net investment is increasing or declining. In the case of accelerated depreciation, the benefit declines if the investment declines, and the benefit is increased as the investment increases. Therefore, accelerated depreciation would be more consistent with the goals which the administration ostensibly is seeking.

INVESTMENT CREDIT IS A "WINDFALL," WHICH SHOULD BE DEDUCTED
FROM THE DEPRECIATION BASE

Under existing law, taxpayers are permitted annually to deduct as depreciation a part of the cost of business or income-producing property over the period of its useful life. The revenue laws are so designed that the taxpayer will recover 100 percent of the cost of the property tax free over the period of its use. The investment credit is not a substitute for this allowance. The investment credit amounts, in essence, to payment by the Government of a part of the cost of acquiring depreciable property. It is logical, therefore, that the taxpayer should use as the cost to be recovered through depreciation only the net cost of the asset to the taxpayer—in the usual case, 92 percent of its gross purchase price. Otherwise, the investment credit will be a "windfall" to the taxpayer. A Republican-sponsored amendment to avoid giving the taxpayer such a "windfall" was rejected by the Democratic majority. The amendment merely required that the taxpayer deduct the amount of the investment credit—the subsidy—from the cost of the property. It is sound and should have been adopted.

Adjusting the basis of depreciable assets by the amount of the credit would also reduce the discrimination inherent in the investment credit in favor of relatively short-lived assets as compared with long-lived assets. While a business buying 8- or 10-year assets will still get an investment credit more frequently than a business investing in 20- or 30-year assets, if the adjusted basis of the assets is reduced by the amount of the credit, the business with the relatively short-lived assets will not have an unwarranted tax advantage over the business with longer lived assets because the former business will not be able to depreciate repeatedly that portion of the cost of the assets for which the Government has reimbursed it.

REPUBLICAN SUBSTITUTE FOR THE INVESTMENT CREDIT

GENERAL

The undersigned members of the committee unanimously recommend that section 2 of the bill, relating to the investment credit, be stricken and that in lieu thereof there be inserted a substitute proposal which will provide for the following:

(1) An elective provision whereby taxpayers will be permitted to take additional depreciation each year in a graduated additional amount comparable to the brackets used for the investment credit. For assets having a useful life of 4 years and under 6 years, the additional depreciation would be 7 percent of the depreciation otherwise allowable. For assets having a useful life of 6 years and under 8 years, the additional depreciation would be 14 percent of the depreciation otherwise allowable. For assets having a useful life of 8 years or more, the additional depreciation would be 20 percent of the depreciation otherwise allowable.

(2) An elective provision whereby taxpayers will be permitted in valuing inventories to deduct and set up as a reserve an amount equal to 20 percent of the first \$100,000 of finished goods purchased and held for resale, with the limitation that the amount deducted in any year will not exceed 50 percent of the net income.

This proposal recognizes the need for tax reform *both* for the manufacturing segment of the economy *and* for the distribution and sales segment of the economy.

The substitution will result in tax deferral—not tax forgiveness or tax subsidy. The continuing revenue loss will “average out” at about \$1 billion per year. Thus, after the initial inventory writedown, the revenue loss is in line with the revenue-producing sections of the bill even if withholding on interest and dividends is eliminated. The proposed substitution would include in the allowance for depreciation the same assets that would qualify for the investment credit.

The provision with respect to depreciation, when coupled with the revision of Bulletin F by the Treasury, should provide industry with the latitude in accounting for depreciation which has been overwhelmingly supported in the testimony before the committee. As a corollary to the relief to industry, we also believe that the Congress should grant relief to the small businessman who must reinvest his funds in inventory. Unless the wholesale and retail trades are willing and able to stock the goods produced by industry, any increased capacity to produce will remain idle.

DISCUSSION OF ADDITIONAL DEPRECIATION ALLOWANCE

GENERAL EXPLANATION

In the hearings before the committee, it was unanimously conceded that the provisions with respect to depreciation allowances for productive facilities, as supplemented by Bulletin F and the Treasury rulings, failed to recognize fully the economic obsolescence of such assets. The Secretary of the Treasury has publicly stated that the useful lives prescribed in Bulletin F will be consolidated and reduced by between 20 and 30 percent. However, he also advised the committee that after such revision, American industry still will not be permitted to amortize the cost of productive equipment as rapidly as its foreign competition. Therefore, we propose to provide for an election whereby the taxpayer can accelerate the depreciation of equipment to a greater extent than the revised Bulletin F.

The proposed amendment provides that the taxpayer will be permitted to take additional depreciation *each year* in a graduated additional amount, analogous to the brackets used for the investment credit:

For assets having a useful life of 4 years and under 6 years, the additional depreciation would be 7 percent of the depreciation otherwise allowable.

For assets having a useful life of 6 years and under 8 years, the additional depreciation would be 14 percent of the depreciation otherwise allowable.

For assets having a useful life of 8 years or more, the additional depreciation would be 20 percent of the depreciation otherwise allowable.

For example, if a taxpayer installs some equipment having a useful life of 4 years on account of which the taxpayer would be entitled under existing law to an annual depreciation deduction of \$100, this amendment would increase the annual deduction to \$107. If the property had a useful life of 7 years, this amendment would increase

the annual deduction to \$114. If the property had a useful life of 10 years, this amendment would increase the annual deduction to \$120.

The additional depreciation provided for in the proposed amendment is based upon a percent of the depreciation otherwise allowed and would automatically reflect any increase in depreciation which might be allowed as a result of the pending Treasury study.

Under existing law, a taxpayer is permitted to compute depreciation under either (a) the *straight line method*; (b) the *sum of the years digits*, or (c) the *double declining balance*. The additional depreciation which would be allowed by this bill is always applied to reduce the taxpayer's overall basis or cost for depreciation purposes. However, the additional depreciation allowed is not charged to the declining balance under the *double declining balance method* in order to reflect more nearly the same proportionate increase as in the case of the other methods.

A comparison of the depreciation allowable under existing law for an asset having a useful life of 10 years and the depreciation which would be allowable if this amendment were adopted, is shown on the following schedule:

DEPRECIATION DEDUCTIONS—COMPARISON

10-year asset, cost \$1,000 (assuming no salvage value)

Year	Straight line		Sum of years digits		Double declining balance	
	Existing law	Proposed amendment	Existing law	Proposed amendment	Existing law	Proposed amendment
1.....	100	120	182	218	200	240
2.....	100	120	164	197	160	192
3.....	100	120	145	174	128	164
4.....	100	120	127	152	102	122
5.....	100	120	109	131	82	98
6.....	100	120	91	109	66	79
7.....	100	120	73	19	52	62
8.....	100	120	55		42	50
9.....	100	40	36		34	3
10.....	100		18		27	

Under the amendment a taxpayer may elect to claim the increased depreciation deductions with respect to all or any part of his eligible assets. He may elect to take the additional deduction in 1 year, fail to elect it for the next year, and then elect it again later on for subsequent years with respect to the same eligible assets. The additional depreciation deductions need not be elected by the taxpayer for the first year in which depreciation is claimed with respect to an eligible asset. The amendment will not increase a taxpayer's total depreciation deductions with respect to an asset over the asset's useful life.

NEED FOR ADDITIONAL DEPRECIATION RECOGNIZED

It is recognized by the majority of the committee and by the Treasury that American industry is currently at a disadvantage with its European competition in the writeoff of machinery and equipment.

The Secretary of the Treasury submitted to the committee an analysis of the depreciation deductions and similar allowances for

industrial equipment in the leading industrial countries compared with similar deductions and allowances in the United States. The Treasury analysis of depreciation disclosed that the average Italian manufacturer is permitted to write off 100 percent of the cost of his equipment in the first 5 years; the average German manufacturer is permitted to write off 67.2 percent in the same period; Japan and the other industrialized countries permit writeoffs ranging from 64 to 100 percent in the first 5 years. The same American manufacturer would not be permitted to write off as much as 50 percent of the cost of his equipment in the first 5 years.

The Kennedy administration thus acknowledges that the depreciation allowances under existing law are inadequate. The Secretary has also acknowledged that the revision of Bulletin F *alone* will not be sufficient. If American industry is to replace its equipment more rapidly, the Congress must liberalize our depreciation policies by providing for an acceleration in the earlier years. In advancing the investment credit proposal, the administration is willing to forego between \$1.8 and \$2 billion in revenues for this purpose. The revenue loss could be better used *in part* to give business the type of depreciation which the Treasury admits business will need in the competitive times ahead. On the other hand, the depreciation substitute which we propose is timed so as not to create a Federal deficit. The revenue loss for the first full fiscal year (1964) will be about \$485 million. This will increase to about \$815 million in the next year as more assets qualify for additional depreciation. Accordingly, the revenue loss will be less than one-half of the cost of the investment credit. Industry and labor have both testified to the fact that the investment credit approach is unsound. In view of the revenue effect *alone*, there is no reason why the Congress should not *in fairness to American industry and to the American taxpayer adopt the depreciation amendment* and give industry the type of tax reform which is needed.

DEPRECIATION PROPOSAL AVOIDS "LOOPHOLES" IN INVESTMENT CREDIT APPROACH

Under the investment credit approach the taxpayer is granted a subsidy for the purchase of specific types of property. The taxpayer is then permitted under the law to recover through depreciation the *full cost* of such property, including the amount subsidized through the investment credit. The taxpayer will thus obtain *both* a tax credit or subsidy *and* a tax deduction for the same expenditure. This obvious "loophole" is avoided in the depreciation proposal, because the taxpayer still will not be permitted to recover through depreciation more than 100 percent of the cost of the property.

The depreciation proposal likewise avoids the "loophole" in the investment credit approach as applied to Government contractors and subcontractors. Depreciation is reflected in the accounting for renegotiation, cost-plus-fixed-fee contracts, or redeterminable price contracts. The taxpayer does not realize any "windfall" because the taxpayer only recovers for actual expenditures.

Similarly, the depreciation approach avoids the problem of the lessor-lessee relationship which is inherent in the investment credit. The lessee does not get a depreciation deduction with respect to leased property. The lessor's depreciation would necessarily bear some rela-

tionship to the rentals received from the lessee. As distinguished from the investment credit, there is no "under the table" bonus to be traded between the lessor and the lessee.

DISCUSSION OF INVENTORY AMENDMENT

GENERAL EXPLANATION

In providing accelerated depreciation, the proposed amendment meets the needs of the manufacturing or productive segment of the economy in which there must be a relatively large investment in depreciable personal property such as machinery and equipment. However, the products of those industries cannot be sold to the consumer without the distributing and retailing segment of the economy. There are more than 1½ million "small merchants" who must stock the increased output of industry if the goods are to be sold. The inventory amendment is intended to facilitate the carrying of that stock.

The small merchant frequently is unable to set aside, after taxes, sufficient income to carry the necessary increases in his inventory which may be required either because of inflation, the introduction of new products, or normal growth. If these merchants are to compete with the large merchandising chains, some form of tax relief is necessary. The inventory amendment will permit the taxpayer to reduce the cost of his inventory by 20 percent of the first \$100,000 of inventory valuation, computed without regard to this section, with the limitation that the inventory adjustment cannot exceed 50 percent of taxable income.

The working of the amendment may be exemplified, as follows:

Assume that the taxpayer, an independent furniture dealer with a closing inventory of \$80,000, had net income of \$23,000. His adjustment for the first year under this section would be \$11,500 (the lesser of $20/100 \times \$80,000$ or $50/100 \times \$23,000$). The taxpayer's taxable income would thus be \$11,500. In the second year, assume that the taxpayer's closing inventory was \$100,000, and his taxable income was \$30,000, both before adjustment under this section. His adjusted closing inventory would be \$85,000 and his adjusted income would be \$15,000. In this example as compared with existing law, the amount deferred in the second year was only \$3,500 because the cost of goods automatically reflected the prior year's adjustment. The net effect would be to allow the taxpayer an additional deduction because of the "growth" in his inventory.

The provision for the inventory adjustment was limited to the first \$100,000 in inventory because numerically more than 95 percent of taxpayers in the distribution and retail businesses have sales with less than \$1 million per year. Such taxpayers would not normally have inventory in excess of \$100,000.

INVENTORY AMENDMENT PROVIDES "EQUITABLE" ADJUSTMENT

The inequity of taxing income from the sale of property, where such property is replaced with similar property at a higher cost, has long been recognized. For example, if a television dealer has an inventory of 12 television sets costing \$1,000, and sells those sets at

retail during the taxable year for \$1,500, the dealer has realized a gross profit of \$500. However, in order to stay in business, the dealer must replenish his stock. If he buys 12 similar television sets at a cost of \$1,100, his actual gross profit is only \$400.

Section 472 of the Internal Revenue Code provides for an elective inventory costing formula (LIFO) which permits the dealer to use replacement cost as the cost of the goods sold. However, the small wholesaler or retailer frequently cannot readily adopt this method of valuing inventories. Section 472 may be too complicated for the small merchant, or the benefits may not justify the cost of accounting on this basis. Whatever the reason, LIFO is rarely used by the smaller businesses.

The proposed amendment will extend a privilege to the smaller businesses, similar to the LIFO formula, for a percentage writedown of the closing inventory which results from costing the goods sold on a first-in, first-out basis. The amendment will not apply in the case of a taxpayer who uses the LIFO formula in valuing inventories since that formula by itself grants some relief against the effects of inflation.

INVENTORY ADJUSTMENT IS TAX DEFERRAL—NOT TAX FORGIVENESS

Since the reduction of the closing inventory value will have the effect of deferring—not exempting—from tax the amount by which the taxable income is so reduced, the inventory adjustment is at the election of the taxpayer. If the taxpayer elects to reduce the closing inventory value, the amount of reduction will automatically be reflected in the opening inventory of the following year, and to continue the deferral of tax the closing inventory of subsequent years (first computed as if the election had never been made) will be similarly reduced unless the taxpayer elects to terminate the election. If the taxpayer terminates his election, the closing inventory for that year is computed as if the election had never been made, with the result that the amounts previously deferred through the inventory reductions are included in taxable income.

The provision will result in an aggregate revenue loss of about \$1.1 billion, which will be spread over three fiscal years as taxpayers exercise the option to take the deduction in the first taxable year that the taxpayers qualify for the deduction. Thereafter, the revenue loss is limited to the net increase in inventories. As inventories fluctuate from year to year, there is no certainty that there will be a continuing revenue loss from this provision.

DISCUSSION OF WITHHOLDING ON INTEREST AND DIVIDENDS

GENERAL

Withholding on interest and dividends attacks the foundation on which the American tax system has produced more revenue voluntarily, notwithstanding excessively high rates, with greater compliance, than any other revenue system in history. Our tax system has derived its strength from the principle of voluntary self-assessment. The withholding provision would seek to destroy this.

Withholding on interest and dividends is an administrative monstrosity. Such withholding will not, and cannot, be handled in the

same manner as withholding on wages and salaries. After extensive hearings, it was apparent to the committee that any procedure for withholding on interest and dividends would result in either (1) massive overwithholding due to the nonrecognition of exemptions, exclusions, and deductions, or (2) administrative chaos if an effort were made to predicate such withholding upon the individual's actual tax liability. The plan finally approved by a majority of the committee, at the "last minute," attempts to straddle the issue. It will produce both massive overwithholding and administrative chaos.

It has been frequently stated that "since there is withholding on salaries and wages, there should also be withholding on interest and dividends." This is a specious argument. In the case of withholding on salaries and wages, there is only one employer-employee relationship at any one time during the taxable year. The employee is permitted to claim any exemptions to which he might be entitled. The rate of withholding on the employee is supposed to take into account his normal deductions. Every effort has been made to be certain that there is no "overwithholding." Even with these safeguards, the Treasury processes more than 40 million refund claims annually resulting from "overwithholding" on salaries and wages.

For millions of small depositors, investors, cooperative patrons, and the like, any withholding means overwithholding. In fact, a withholding rate of 20 percent is higher than the average effective tax rate for most recipients of interest and dividends.

BILL WILL PRODUCE MASSIVE OVERWITHOLDING

In a statement as recent as January 25, 1962, the Commissioner of Internal Revenue estimated that there were more than 350 million interest and dividend accounts which would be affected by withholding if applied only to payments of \$10 or more. If we add to this number all the other holders of Federal savings bonds, the patrons of the cooperatives, those receiving interest or dividends from insurance companies, to mention only a few, where the amount subject to withholding would be less than \$10, the total number of accounts becomes astronomical—at the very least there will be 500 million accounts subject to withholding. Exemption certificates must be filed for all of these accounts—*each calendar year except where based on age (under 18) or withholding will apply.*

The provision for an exemption certificate will only be available to a very small number of these individuals. In order to give an exemption certificate, the individual must certify "that he reasonably believes that he will not * * * be liable for the payment of any tax," after the allowance of certain credits. None of the individual's exemptions or deductions are taken into account in determining how much of the individual's income, otherwise subject to this withholding, will be subject to any tax. Unless the individual "*reasonably believes*" that he will be able at the end of the tax year to file a return showing absolutely no tax liability whatsoever, the individual cannot give an exemption certificate. The possibility that an individual might owe \$1 in tax subjects that individual to withholding at a rate of 20 percent on all of the individual's income from interest, dividends, and the like.

Furthermore, while there are procedures for quarterly refunds, an individual cannot file such a claim if his gross income for the taxable

year will exceed \$5,000, if single, or will exceed \$10,000, if married or the head of household. Thus, it would be a cruel deception to assure any of these many millions of individuals that the withholding contemplated by this bill contains any exemption, or refund procedure, which would assure them of not being deprived of 20 percent of their interest and dividend income even though no tax might be due on such income.

If withholding on salaries and wages where the taxpayer is given the benefit of all of his exemptions, together with an effective rate which reflects the standard deduction, produced more than 40 million cases of overwithholding, the number of cases which will be produced by this bill defies imagination. The Treasury would be inundated by claims for refund, if all of these individuals were permitted to file a claim whenever an amount had been withheld which was not due. Obviously, the Treasury recognizes that many of these individuals will forget or not go to the trouble and expense of filing a claim for a nominal amount. Since no record will be kept by anyone else, the majority is placing this burden on the individual with the expectation and hope on the part of the Treasury that the individual will be practical and not bother with nominal amounts.

PROPER WITHHOLDING PROCEDURES ARE NOT CONTEMPLATED

The basic distinction between withholding on interest and dividends and withholding on salaries and wages was recognized when the Kennedy administration first proposed the former. In the President's recommendations on tax revision, the following was proposed:

The proposal provides for withholding of income tax on interest and dividend payments at source. It is a simple and fair system. It would minimize the additional work of interest and dividend payers. No withholding receipts for payees would be required. No payer records of withheld tax by individual payee would be required. There would be no exemption of payees from withholding. *As a consequence, across-the-board withholding would necessarily involve overwithholding on payments made to tax-exempt organizations and to certain individuals.* The proposal, however, provides corrective devices to accelerate recovery of such overwithheld amounts (Hearings before the Committee on Ways and Means, 87th Cong., 1st sess., on "The Tax Recommendations of the President," Apr. 20, 1961, vol. 1, p. 272). [Italics supplied.]

The reasons for the "no exemption" rule, undesirable as it might be, was stated to be that any attempt to maintain individual withholding accounts either by the Treasury or by the payers would more than offset the supposed advantages of withholding. Accordingly, the statement continues:

Withholding agents would withhold at 20 percent from all interest and dividend payments subject to withholding. The agent would not be required to keep records of tax withheld from each recipient, nor would the agent be required to provide withholding receipts to the recipients. The withholding agent would merely remit to the Internal Revenue

Service 20 percent of the total interest or dividends payable (*ibid.*, p. 273).

In recognition of the massive overwithholding which would result from this proposal, the majority of the committee were not willing to approve a "no exemption" approach to withholding on interest and dividends. In fact, the exemption provision in this bill for individuals 18 years of age and over is identical in terms to the provision in the discussion draft of August 1961. It was opposed by the Treasury because of the resulting confusion which such a procedure would create. For that reason, the majority first proposed to limit the exemption certificate to individuals 65 years of age and over. It was opened up to all individuals when it became obvious that this would still leave a large group subject to withholding for a tax which was not, in fact, owing to the Government.

Nevertheless, the bill does not provide for withholding on interest and dividends analogous to the existing law with respect to salaries and wages. The taxpayer is not permitted to claim any exemptions or deductions, or to make any estimate of his tax, except for the "pauper's oath" exemption. There will be massive overwithholding.

Furthermore, under this bill the individual is not notified that any amount is withheld from his interest and dividends. The withholding agent does not supply the Treasury with any list setting forth the names of the individuals from whom taxes have been withheld, and the amount withheld as is required under wage and salary withholding. There is no procedure whereby the individual is advised as to the total amounts, or the separate amounts, which have been withheld from payments otherwise due to him. Obviously, there will be a large sum collected by the Treasury to which it has no right. No plan has been proposed to refund this sum in the absence of a claim. This feature is the real "revenue producer" in the withholding scheme.

INFORMATION RETURNS SHOULD BE SUBSTITUTED FOR WITHHOLDING

The amount of *taxable* income in the form of dividends and interest, which is not reported for tax purposes, has been greatly overstated by the Treasury. Withholding will result in depriving many people of their money who will not owe any tax. While this effect is only temporary on a single-transaction basis, it is a permanent loss on a continuing basis because notwithstanding any refund procedure, the Treasury will always have money belonging to the taxpayer.

The administration sought and Congress last year enacted legislation requiring the assignment of taxpayer identification numbers. This legislation is now being implemented. In the meantime, the Internal Revenue Service is making enormous strides in the direction of automatic data processing of tax returns. The net result of these two developments has been to make feasible the mechanical matching of tax returns with information returns (Form 1099). All taxpayers are to be given a number. There are reporting requirements in the law whereby the companies report interest and dividends. The Treasury last year carried out a cooperative educational campaign with business. The object was to remind interest and dividend recipients of their tax obligations on such income. The Kennedy administration has again asked business and the financial industry to

conduct a similar campaign this year. This is a strange request indeed, if the administration is now convinced that last year's efforts were not effective.

In balancing the administrative problems incident to the use of information returns, as distinguished from "across the board" withholding as originally proposed by the Kennedy administration, the Commissioner of Internal Revenue in a statement before the New York Bar Association, on January 25, 1962, estimated that there would be more than 250 million information returns on interest alone even if all payments under \$10 or less were exempted. The Commissioner stated:

These are some of the "paper" consequences of the information-reporting alternative to withholding. The cost of simply processing 250 million 1099's into our ADP system, incidentally, would come to \$5.5 million a year. And, after we finished the processing, the entire operation would have directly produced for us in tax not one dollar. We could, however, expect the psychological effect of broader information reporting and electronic matching to bring about some improvement in voluntary compliance.

A match of the 1099's against tax returns would only identify the individual who apparently hadn't properly reported all dividend-interest income.

It would only *show* us where the potential tax was. Information reporting and ADP obviously do not collect the tax. Further *positive* action would be required of us—through correspondence, office auditors, internal revenue agents and revenue officers.

Since the taxpayer is paying for the cost of the "ADP system," we feel that the convenience of having such a system should be passed on to the taxpayer. Otherwise, there will be withholding on the same 250 million interest payments of \$10 or more, together with a much greater number of payments of less than \$10, if the individuals do not, or cannot, file the "pauper's oath" type of exemption certificate.

Furthermore, withholding does not even assure that all taxes will be paid on interest and dividends. While a withholding tax may be collected from many millions of small depositors having no tax liability, there is nothing inherent in the withholding procedure to assure that the correct tax will be paid by those taxpayers who are in a higher tax bracket than the withholding rate of 20 percent. Withholding merely assures that a tax of 20 percent will be paid on all income paid in the form of interest or dividends, irrespective of whether the actual tax might be less or might be at a considerably higher rate.

The commercial banks have a total of \$62 billion in deposits in 52 million separate accounts. The total interest paid on these accounts is \$1.8 billion per year. In more than 40 percent of the accounts, the interest paid amounted to less than \$12 per quarter. In almost two-thirds of the accounts, the interest paid, amounted to less than \$12 per year. The interest paid on about 32 million of these accounts did not exceed \$62 million in the aggregate. There will thus be 32 million accounts involving the withholding of less than 40 cents. Obviously, withholding is proposed with the knowledge and expectation that many of the depositors in these accounts will not undertake

to file either an exemption certificate or a claim for refund in order to recover a tax of less than 40 cents. The cost to the Government in processing a claim for 40 cents would in itself make the withholding impracticable. In effect, this is nothing more than a "nuisance" tax.

WITHHOLDING A "NUISANCE" TAX

The number of shareowners having a stake in American industry has more than doubled. More than 15 million Americans own shares in our corporations. More than 3 million of these are shareholders with low incomes, for whom the limited relief from double taxation of their savings in American industry makes their investment worth the risk. The law exempts \$50 in dividends from tax. Now we are going to nullify that exemption by a withholding tax, where there may be no tax liability. Many millions of shareholders will find the filing of claims too onerous or will overlook filing claims for the refund of nominal amounts.

The savings and loan associations have a total of \$68 billion in deposits, in 29 million accounts. More than 7 million depositors receive "interest" (dividends) of less than \$10. The Government will unjustly enrich itself, at the expense of the small depositors, for a tax which is not due.

WITHHOLDING IS A TAX ON CHURCHES, CHARITABLE ORGANIZATIONS, AND PENSION FUNDS

According to the report of the Securities and Exchange Commission, there were approximately \$30 billion assets held in pension funds which would be subject to withholding. The average return made on such funds amounted to 3.64 percent, resulting in more than \$1 billion available for immediate reinvestment. Even assuming prompt quarterly refunds, under this bill approximately \$54 million of the income from pension funds would be continually sterilized. There would be a permanent loss to the pension fund of this sum because of the overlapping between the time of withholding and the quarterly refund of amounts previously withheld.

In addition to pension funds, for which accurate statistics are available, there are even greater amounts invested by churches, charitable organizations, our universities, schools, and the various charitable foundations. The income from these investments, except for minor exemptions, will be subject to withholding. Through unnecessary withholding, these organizations will at all times be deprived of a part of their income. They are not subject to any tax liability either for withholding on salaries and wages, or otherwise, against which they might offset the relatively larger amount which will be withheld from them. It is difficult to understand why, if exemptions are to be granted to individuals who might have no tax liability, the same privilege should not have been extended to organizations which by law are exempt from tax. No justification for this discriminatory treatment of tax-exempt organizations was advanced by the majority during the course of the committee's consideration of the bill.

TAXATION OF SHAREHOLDERS OF "CONTROLLED FOREIGN CORPORATION"

GENERAL

The undersigned members of the committee are unanimously opposed to the "blunderbuss" approach in the bill with respect to taxation to the shareholders of the undistributed income of a "controlled foreign corporation" (sec. 13). The allocation formula under section 482 (sec. 6 of the bill) will prevent the avoidance of U.S. taxes on income shifted to the so-called "tax haven" company. In going beyond that point, the bill is designed to penalize American business on legitimate foreign operations.

A "controlled foreign corporation" is defined in the bill as any corporation of which more than 50 percent of the voting stock is owned directly or indirectly by American taxpayers. It need not be affiliated with or a subsidiary of another American corporation. With minor exceptions, section 13 of the bill would tax to such American shareholders, whether corporate or otherwise, the earnings of the foreign corporation doing business abroad, irrespective of whether the foreign corporation distributes such income to, or has any transactions with, or ships any products to the United States. In this provision by one stroke the "new frontier" has set out to orbit the globe with our tax laws. Our revenue agents will be the "astronauts" of the future.

This unwarranted extension of our tax laws beyond our shores would be a blunder in our foreign relations far overshadowing the ill-fated Cuban invasion. It would destroy more than 15 years of effort on the part of prior administrations, both Democrat and Republican, to promote and expand the opportunity for American business in the world market as an integral part of the U.S. foreign policy. In seeking thus to stem the deficit in the balance of payments it will have the opposite effect.

TAX ON CONTROLLED FOREIGN CORPORATION UNCONSTITUTIONAL

Section 13 of the bill has little relation to possible evasion or avoidance of U.S. tax, but is admittedly designed to reduce foreign investment. The constitutionality of this taxation of American shareholders is open to serious question. In fact, counsel for the Joint Committee on Internal Revenue Taxation has advised the committee that Congress cannot constitutionally tax shareholders on the undistributed income of foreign corporations, except in cases where such taxation is reasonably necessary to prevent evasion or avoidance of tax (Hearings before the Committee on Ways and Means, 87th Cong., 1st sess., on "The Tax Recommendations of the President," Apr. 20, 1961, vol. 1, pp. 311-313). The settlement of this question will produce long and costly litigation. Neither taxpayers nor the Government will know for years whether this unprecedented experiment in tax jurisdiction will be sustained by the courts.

REVERSAL OF U.S. FOREIGN POLICY

For more than 15 years, we followed the premise that greater participation by American business in the European economy was a major objective of the U.S. foreign policy. The expansion of American business into the world markets was universally accepted as essential to

the security and survival of the free world. This policy was actively pursued by Democrat and Republican administrations alike. "Trade not Aid" was the popular slogan of the day. As a corollary to this policy, it was also recognized that the American businessman abroad must be permitted to avail himself of the same laws and customs that were available to the nationals of the other industrial nations—for it was with these other nationals that the American businessman must compete.

As recently as February 9, 1960, this committee reported out a bill entitled "Foreign Investment Incentive Act of 1960" designed to aid American business competing abroad (86th Cong., 2d sess., H.R. 5, H. Rept. 1282). The majority report contains the following statement:

The postponement of American tax as long as the funds are used in foreign operations is necessary to place the U.S. corporations operating abroad on a competitive basis with other corporations (either U.S. or foreign owned) which operate in the same foreign countries and pay only the taxes of the foreign countries. However, by ending the deferral of U.S. tax at the time the funds are brought back for use in the domestic market or for distribution to stockholders, your committee's bill provides assurance that a tax at least equal to the full U.S. tax will be paid before the funds enter the domestic market (*ibid.*, pp. 1-2).

As the committee pointed out in that report, the policy of not attempting to tax earnings of a foreign corporation before repatriation had long been recognized as essential to supplement the U.S. foreign policy as well as to enable American-owned corporations to meet their foreign competitors on an equal basis. The majority report further stated:

The need for deferring the imposition of U.S. tax in the case of domestic corporations has long been recognized. It was advocated by the State Department as a part of the point 4 program in a publication issued in 1949. It also was advocated by the President in his budget message in 1954. At that time tax deferral was provided for in legislation passed by the House but was not finally enacted. More recently tax deferral for foreign income has been advocated in two reports published in 1959 under the auspices of the administration. It has also been advocated in testimony before your committee by representatives of the Treasury Department for use in the less developed countries—the countries where, because their tax rates generally are lower, deferral of U.S. tax has its greatest impact (*ibid.*, p. 2).

Section 13 of the bill is a complete reversal of the policy recognized and approved by this committee in that report—not because the policy was not effective—on the contrary, it can be said that the concern of the Treasury stems from the fact that the policy succeeded. Western Europe was transformed from a debtor to a creditor of the United States. The policy was, and still is, sound. Section 13 of the bill contradicts that policy. It is advanced by the majority, in part

at least, as a means of improving our balance of payments. It will have the opposite effect.

In the long run, foreign investment is helpful to the balance of payments, because a dollar invested abroad increases exports from the United States and produces dividends to the American investor which ultimately exceed the dollar invested. This fact is not disputed.

CONTROLLED FOREIGN CORPORATION TAX IS "ISOLATIONISM" AT ITS WORST

The argument was made that existing laws with respect to taxing of foreign income encouraged the "exportation of jobs." Therefore, the bill proposes to penalize American business operating in the more developed countries. This argument is premised upon the fallacious assumption that American business goes abroad to avoid U.S. taxes.

In the past decade there has been a considerable movement of business from the heavily industrialized States such as the New England States, Michigan, Pennsylvania, Ohio, and New York, to the less industrialized Southern States such as Arkansas, the Carolinas, Virginia, Alabama, Georgia, and Mississippi. Members of the Congress from the States gaining new industries as well as the States losing old industries, well know that Federal taxes obviously had no part in bringing about this movement.

Any attempt to keep American business at home through the tax laws is "isolationism" at its worst. The tax laws would then become the equivalent of a discriminatory tariff or duty, applicable only to the American-owned business operating overseas but not to its foreign-owned competitor. There is no evidence that industries have "exported jobs" to the more developed countries. In a few instances, perhaps, American-based companies established foreign plants to produce goods for the American market when they could no longer compete with foreign imports. However, this is the exception. Until such time as the Congress can be assured that American-made products can be freely traded in the European market, it would be a great mistake to penalize the American businessman for going abroad in order to make his place in that market.

The administration purports to seek "equity" between U.S. firms operating abroad and competing firms located in the United States. This fallacious reasoning completely ignores the fact that American-owned foreign corporations must compete in a foreign country with foreign corporations which are foreign owned. The American-owned foreign corporation can successfully meet this competition only so long as it is able to operate under the same rules as its foreign competitor. If the American firm cannot invest abroad, foreign capital will take its place. The income flowing back to the American investor will be less and our balance of payments will be adversely affected.

Of the 14 major industrial nations, there is not one which taxes undistributed earnings of nonresident foreign subsidiaries. Seven of our major competitors (Australia, Belgium, Canada, Denmark, France, Norway, Switzerland) have adopted tax incentives to boost foreign investment by eliminating or reducing taxes on dividends from foreign subsidiaries. Most Latin countries have eliminated taxes on dividends from foreign subsidiaries. In the United Kingdom,

an overseas trading corporation even though organized and managed locally, can do business abroad and pay no United Kingdom tax until a dividend is paid. It is the companies of these countries which form the competition. They include such names as Mitsui, Mitsubishi, Krupp, Bayer, Hoechst, Unilever, Shell, SKF, Imperial Chemicals Industries, Montecatini, Pirelli, Michelin, British Motor Corp., Renault, Societe Generale, and a host of others. They are aggressive, skillful, progressive, and well financed. The bill will put an almost unbearable strain on the ability of American-owned foreign subsidiaries to compete with those foreign companies.

The real purpose of this part of the bill is to prevent American business from operating in the world market—an astounding proposition in view of the Kennedy administration's trade program. When taken together, the administration would invite the foreign-owned producer to come in duty free, while locking his American-owned competitor in the closet.

THE AVOIDANCE OF FOREIGN TAXES IS NOT A "LOOPHOLE"

The earnings of foreign corporations operating abroad are subjected to U.S. income tax when distributed to U.S. shareholders. That is the generally accepted rule with respect to all corporations, both foreign and domestic. Neither the United States nor any other major country has attempted to tax the earnings of a foreign corporation not doing business within its jurisdiction unless and until those earnings become available to the shareholders over whom the taxing authority has jurisdiction. Our many tax treaties are based upon this principle of law.

The use of a so-called "tax haven" company to minimize taxes in foreign countries on transactions emanating from those countries is a practice common to foreign-owned corporations as well as American-owned corporations. If West Germany, for example, is willing to permit such a practice on the part of German corporations, there is no reason why the United States should place its nationals at a disadvantage in competing in the world market with products manufactured by German-owned German corporations.

The use of a so-called tax haven to insulate profits for operations which take place wholly outside of the United States is not a "loophole" in the U.S. tax laws. There is no justification for taxing income earned by a foreign corporation on transactions occurring outside of the United States merely because of American shareholders. Until the foreign corporation distributes that income, the American shareholders have not realized any income on which a tax can be levied.

Any effort to avoid U.S. taxes by means of fictitious exchange prices can be covered under section 482. More frequently, the intermediate corporation is used to avoid foreign income taxes in the country of ultimate destination. This should not be of concern to the United States.

TAXATION OF FOREIGN INCOME SELF-DEFEATING

The use of a so-called "tax haven" by an American-owned foreign company to minimize the impact of foreign taxes produces more tax revenue for the United States. The corporate tax rates in the major European countries are about the same as the U.S. rate. When

funds are repatriated directly from those countries, there is no U.S. tax because of the effect of the foreign tax credit. However, if the American-owned foreign company can minimize the impact of these foreign taxes, the available foreign tax credit will be reduced, and the ultimate tax paid to the United States will be increased. The U.S. tax will yield more, not less, revenue because of the use of a so-called "tax haven" company.

Other foreign countries may increase their tax on the export companies in order to soak up the differential in tax which would otherwise go to the United States. In that event, the sole result of the provision will be to handicap American business, with no additional tax revenue to the United States. From any aspect, the provision is self-defeating.

The bill is thus more likely to increase the tax revenue of foreign countries than to bring in additional U.S. tax. The provision attacking "export sales" from one foreign country to another are aimed at situations where the only tax which can be considered to be avoided is that of a foreign country. The provision seems to be designed to force incorporation in the country of destination of the goods, rather than to produce any actual revenue. This provision even handicaps exports from the United States by foreign subsidiaries buying at legitimate prices from their domestic affiliates. Some of the underdeveloped consuming countries do not have laws under which local incorporation can satisfactorily be accomplished.

The "export sales" concept appears to be primarily directed at the so-called tax haven marketing companies incorporated in Switzerland and other "low-tax" countries. U.S. taxation of the income of American-controlled Swiss marketing companies will only drive American business out of the European market. The network of tax treaties between European countries and the favorable treatment which some of them, regardless of treaties, afford to dividends from foreign subsidiaries (e.g., Belgium, the Netherlands, Norway, and France, as well as Canada and Australia) fosters the use of Swiss marketing subsidiaries by the principal competitors of American business, and gives them tax advantages over American business even under the present U.S. tax law, without the added burden of this bill.

PROVISION CREATES CONFUSION AND DISCORD

Section 13 of the bill will create staggering administrative difficulties for the Treasury and place great accounting burdens on taxpayers. Accounting methods in foreign countries, both for tax and corporate purposes, differ from U.S. tax accounting, which must be applied under the bill. Is the Treasury prepared to accept returns without examination of these problems, or does it plan to send swarms of agents all over the world? If the latter, will the effect of their expenses abroad on the balance of payments be less than whatever additional inward remittances may actually be produced by the bill? The amendment to section 482 contained in the bill will defeat the only type of real U.S. tax avoidance which could be charged against the use of foreign corporations. The Treasury advocated this as a solution of administrative burdens with which its present staff could not cope. Relief from that problem will certainly not free enough Treasury employees to handle the Pandora's box of problems which

will be opened by this attempt to give worldwide application to the U.S. law.

Where, as is becoming more and more the case, a substantial stock interest in a "controlled foreign corporation" is held by foreign nationals, conflicts will arise as to operating and dividend policies between them and the U.S. shareholders. The foreign shareholders will not be interested in reorganizing corporate structures or in changing methods of operations to comply with the patterns which the bill seeks to dictate. They will not see why reinvestments should be confined to the American Government's ideas of what is to be permitted. Finally, if the American shareholders are to be taxed, they will want dividends of at least enough to pay the tax, and such distributions may conflict with the plans and interests of the foreign shareholders.

The policy of the bill may conflict with foreign legal requirements as to the establishment of reserves or with other limitations on distribution of earnings. Foreign governments will resent and resist intervention by U.S. law into the internal affairs of corporations existing under their laws, especially when partly owned by their nationals.

The bill leaves the designation of so-called "less developed" countries to the discretion of the President, uncontrolled except for a list of 20 countries which cannot be designated. Mere failure to issue the required Executive order will prevent the most primitive areas in the world from being recognized. American businessmen will not know from year to year what areas will qualify. They will be at the mercy of changing Executive opinions as to the areas of the world which should be relieved from the handicaps on reinvestment provided by the bill. Legitimate plans for the operation and expansion of a business in such a country, made when a favorable Executive order was in effect, can be upset by its later revocation.

CONTROLLED FOREIGN CORPORATION TAX VIOLATES TAX TREATIES

As recently as March 8, 1961, the Committee on Foreign Relations of the Senate reported for ratification the Convention of the Organization for Economic Cooperation and Development, together with two protocols relating thereto signed in Paris December 14, 1960 (87th Cong., 1st sess., Senate Executive Report 1). The Organization of Economic Cooperation and Development (OECD) superseded the Organization for European Economic Cooperation. A fiscal committee composed of representatives of the 18 member states, including representatives of the U.S. Treasury, prepared articles to be included in a draft convention for the avoidance of double taxation with respect to tax on income and capital. The Council of the OECD recommended that the member states adopt those articles in existing conventions and in negotiating future conventions. These recommendations became binding upon the United States as a member of the OECD.

The United States has income tax conventions with 14 of the 19 present members of the OECD, i.e., Sweden, the United Kingdom, Germany, France, Netherlands, Denmark, Norway, Switzerland, Austria, Italy, Belgium, Greece, Ireland, and Canada. All of these conventions are predicated upon respect by the United States for the existence of a corporation of the other contracting states as a legal entity with a jurisdictional personality distinct from its American and

other shareholders. Consequently, the American shareholder as well as other shareholders are taxable only on those profits which are distributed by the company. This is clear in paragraph 5 of article XX of the convention concerning the taxation of dividends. Paragraph 5 reads as follows:

Where a company which is a resident of a contracting state receives profits or income from the other contracting state, such other state may not levy any tax on the dividends paid by the company to persons who are not residents of that other state, *or subject the company's undistributed profits to a tax on undistributed profits*, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other state. [Italic supplied.]

In explanation, the commentary on article XX states:

Paragraph 5 adopts a provision already contained in a number of conventions. It rules out extraterritorial taxation of dividends and further provides that nonresident companies are not to be subjected to special taxes on undistributed profits.

By becoming a member of the OECD, the United States agreed that this recommendation, in the preparation of which the U.S. Treasury participated, would apply. Thus a special tax levied on the undistributed profits of companies in other OECD countries would obviously be in contravention to the spirit of paragraph 5 even if the tax is collected solely from American shareholders.

The same is true under the U.S. tax conventions which are in force with Finland, Australia, New Zealand, Union of South Africa, Japan, Pakistan, and Honduras. The same principles are inherent in those which have been signed by Egypt, India, and Israel and are awaiting ratification.

These principles are also in the laws of all the countries of the free world with which the United States has diplomatic relations and is bound by international comity.

CONCLUSION

The Republican members of the committee favor sound tax reform. In fact, the only major revision of our tax laws in the last 30 years was undertaken in the Eisenhower administration, over the vehement objection of many Democratic members of the committee. Our objective in tax legislation should be to simplify, not to compound tax problems; to remove, not to add complexities to the law; and, as a bare minimum, to avoid creating any new "loopholes". This bill is a patchwork of "tax juggling" which moves in the opposite direction.

In the investment credit, the bill provides a new "loophole", which dwarfs all others by comparison. In the controlled foreign corporation tax, it provides the framework of a whole new set of tax laws which will become more complex than all existing laws dealing with the taxation of American companies. The withholding provision assures administrative chaos, attempting to reach separately more than 500 million transactions which under existing law are consolidated in the

returns of individual taxpayers. For the reasons stated in this report, we are opposed to the bill.

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FURTHER VIEWS OF HON. THOMAS B. CURTIS

I have joined with my Republican committee colleagues in signing minority views which appear elsewhere in this report. I am opposed to the enactment of H.R. 10650 for the reasons expressed therein, and because, in my judgment, this legislative embodiment of the Treasury Department's virulent assault on American free enterprise constitutes a muddled hodgepodge of dangerously bad tax policy. The bill would make inevitable an American economic retreat at home and abroad and would increase the control of private enterprise by the heavy hand of Government bureau.

My purpose in filing these further views is to emphasize opposition to the provisions of H.R. 10650, which would impair the ability of American enterprise to compete in international commerce. These further comments will be limited to those provisions directly affecting the taxation of income from foreign sources.

I write in alarm over tax changes originally urged by the U.S. Treasury Department which in my considered judgment would subserve the aims of our enemies and would subvert the vitality of our economic endeavors both at home and abroad.

The changes included in the bill which threaten to be particularly hurtful to the American interest are:

(1) The gross-up proposal (sec. 11): This change would require a U.S. corporate shareholder to include in its income subject to the U.S. tax the amount of foreign tax paid by a foreign subsidiary to a foreign country even though such amount of taxpayment has not been and can never be received as a dividend by the U.S. shareholder. And

(2) The controlled foreign corporation tax (sec. 13): This change would provide that a U.S. shareholder owning as little as 10 percent of a so-called controlled foreign corporation (at least 50 percent American owned) would be currently taxed under U.S. tax laws on foreign earnings of the foreign corporation even though such U.S. shareholder has not received and may never receive these earnings as a dividend from the foreign corporation.

In the ensuing paragraphs I will comment on these two proposed changes by referring, first, to general criticisms that are mutually applicable to both of the changes and, secondly, to those criticisms that are peculiar to one or the other of the enumerated changes.

GENERAL CRITICISMS

These Treasury-espoused tax changes affecting foreign income threaten the ability of American private enterprise to compete and share in world trade. These changes would tax American industry and commerce on veritably phantom income—income that has never been received—under arbitrary and unprecedented tax concepts forcing a retrenchment in the role of American business in domestic and foreign trade. The resulting impairment of our contribution to free-

world strength and progress would be a major benefit to the Communist bloc. To the extent that there is a tax-induced decrease in the role of the private sector of our Nation's economy in the development of the emerging countries, there will be increased dependence on less effective government-to-government aid at a vastly greater cost to the U.S. taxpayers.

In specific reference to the impact of these unwise tax changes on the ability of American enterprise to compete in world markets, it should be realized that the proposals would seriously aggravate the tax disadvantages which are imposed even under existing U.S. tax law on American-owned foreign enterprises.

The following are offered as examples of more favorable tax treatment accorded by Common Market countries to their nationals engaged in world commerce. The Netherlands and Italy exempt all foreign income from home taxes, Belgium applies a very low rate, and France applies either a low rate or complete exemption. It should also be noted that European countries largely avoid the double taxation of corporate profits such as occurs under our tax system. Thus, it is clear that the Treasury recommendations would make the tax burden disparity against U.S. enterprise even more onerous in the world competitive markets.

Treasury Secretary Dillon, in insisting on the destructive foreign business tax rules contained in this bill, supported his position by stating before the Committee on Ways and Means that the finance ministers of the six European Common Market (EEC) countries---

* * * informed us of their unanimous belief that the United States would be justified in discontinuing the fiscal incentives which encouraged the nonremittance of profits made in Europe.

Presumably the Treasury Secretary is more responsive to the "unanimous belief" of the Common Market finance ministers than he is to the overwhelming and substantially uncontradicted testimony in the hearings before the House Committee on Ways and Means to the effect that these proposals would be destructive of a major portion of American overseas operations.

These finance ministers urged the present administration to enact what one of my esteemed committee colleagues ably termed "Yankee, come home" laws--and this bill foolishly proposes to do just that.

The Treasury Secretary failed to inform the committee membership of a single instance of an EEC finance minister trying to have his own country impose destructive tax burdens on its national companies doing business outside of the home country. Any unwise endeavors of this sort in a EEC country would probably be recognized as cause for the removal of the erring finance minister.

Unfortunately, the benefit from the enactment of the gross-up and controlled foreign corporation proposals at the expense of American enterprise would not be restricted to European Common Market producers. The "foreign-owned" competitors of American overseas companies include the increasing economic activities under the control of Iron Curtain countries. The policies implicit in the foreign tax provisions of this bill indicate a shocking unawareness of the benefit the Communist countries would derive from curtailed American overseas economic endeavors as a consequence of added U.S.

tax encumbrances. If the Treasury foreign income tax proposals are enacted, Mr. Khrushchev will have some degree of success in making good on his promise of November 1957 to "win over the United States" in the "field of trade."

Aside from concerns over these proposals that relate to national economic goals and free world political aims, there are other basic factors that must be taken into account in evaluating the question of increasing tax burdens on American free enterprise endeavors in international trade at this time. One of the most important of these other factors is the pressing need to foster an improved equilibrium in our balance-of-payments position.

When it is considered that since World War II there has been a substantial net inflow of money into the United States from direct investment abroad, it is paradoxical that one of the main points in the Treasury argument in behalf of its proposal is the balance-of-payments problem. The implication in the Treasury position is that America should resort to a risky short-run expedient to deal with a balance-of-payments deficit, even though the long-run consequences of such an action would be to aggravate and tend to make chronic the very balance-of-payments problems that the expedient seeks temporarily to alleviate. The Treasury argument completely disregards the very substantial contribution to a favorable balance-of-payments position that is made by U.S. exports stimulated solely by American investment overseas; these are exports that make American jobs for American workers.

Another important factor that must be considered in making a judgment with respect to the Treasury foreign income proposals pertains to the benefits that are derived from American management and control of overseas operations. Because of the higher U.S. taxes relative to foreign taxes, the Treasury proposals would operate to make portfolio investment in foreign-controlled corporations more attractive and more feasible than direct U.S. ownership of a controlled corporation. To the extent that American investors shift from investment in U.S. controlled and operated foreign subsidiaries to minority positions in foreign controlled and operated companies, we would lose the export benefits we derive from American management preferences for U.S. manufactures and the advantages we derive in "know-how", patents, and secret processes. In addition, we would lose the national defense benefits from American control of foreign business activities. Also, the shift from investment in U.S.-controlled foreign subsidiaries to investments in foreign-controlled enterprises would constitute a serious blow to American persuasion and prestige in international affairs. Finally, this shift to foreign portfolio investment can only aggravate the balance-of-payments problem.

The existence of U.S.-controlled overseas companies does not result in the "export" of American jobs. The business of such a company will continue to exist abroad—either as an American-owned or a foreign-owned business. The jobs are there and they are overseas. The issue is whether the employers will be the American-controlled overseas companies or the foreign-owned competitor companies. Removing the American flag from an overseas company will not automatically remove a factory's production, or the market demand for it, from the world market. Any vacuum will be quickly filled by a

foreign-owned company. Instead of resulting in the export of jobs the U.S. control of overseas companies accounts for substantial merchandise exports to, or developed by, U.S. foreign subsidiary companies. According to data submitted to the committee on Ways and Means by the Department of Commerce and appearing on page 430 of the 1961 hearings on the administration's tax recommendations, such American exports with respect to U.S.-controlled foreign subsidiaries amounted to \$2.2 billion in 1959 and \$2.7 billion in 1960.

The foregoing has represented a discussion of some of the considerations and consequences that attend both the gross-up and the controlled foreign corporation recommendations of the Treasury Department as approved by the committee majority. I will next briefly comment on some of the pertinent factors that bear primarily on one or the other of these proposed tax changes.

CRITICISM OF THE GROSS-UP PROPOSAL

In evaluating the gross-up concept it should be remembered that it involves the imposition of a U.S. tax on an amount paid as foreign tax to a foreign country by a foreign corporation on foreign income and that the hapless U.S. taxpayer has not received the amount and can never receive the amount to which the U.S. tax is applied. Thus, it is an actual tax applied to nonexistent income.

The only basis on which the validity of the gross-up can be argued is the superficial contention of "equal" tax treatment predicated on an arithmetical concept that cannot stand up under the overwhelming persuasion of the substantive factors militating against the gross-up. Examples of such substantive considerations are—

(1) The gross-up does not "equalize" the tax treatment between foreign branch and foreign subsidiary operations nor does it "equalize" the risks involved in foreign and domestic investment. Foreign branch operations give rise to many tax benefits not available to foreign subsidiaries. The "equality" argument also fails to recognize the greater risks attending foreign investment involving less stable economies, foreign exchange problems, political uncertainties, and expropriation dangers.

(2) The argument for the gross-up based on a concept of arithmetical nicety completely overlooks the fact that the foreign tax credit is admittedly not a precise measurement of foreign taxes paid and does not allow an offset for the many foreign taxes not based on an income tax concept—such as turnover taxes, net worth taxes, capital stock taxes, property taxes, etc.—which frequently comprise the major revenue and tax burden factors in a foreign country.

(3) The gross-up ignores the economic reality of bitterly contested competition in the marketplaces of the world, and goes in the face of the unrefuted testimony presented to the committee in public hearings last spring that the gross-up would seriously aggravate the existing tax disparity against U.S. industry and make it more difficult for American business to survive and compete in international trade.

(4) The principal tax impact of the gross-up in terms of increased tax burdens on American economic endeavors would be with respect to activity in the so-called developing or emerging nations, including the Latin American countries. Thus, the

gross-up would be inconsistent with our announced foreign policy objectives and would markedly encumber the contribution of private enterprise to the realization of the goals outlined in the alliance for progress. It would also tend to be inconsistent with the foreign trade policy objectives recently enunciated by the President.

(5) The gross-up would be violative of 13 existing tax treaties under which the United States has obligated itself to tax the return on investments in these countries only in accordance with the tax credit formulas in effect at the times the treaties were negotiated. It is to be regretted that the views of the State Department on this point of treaty violation were not made available to the Committee on Ways and Means and to the House.

(6) The gross-up would change the tax rules applicable to income derived from foreign operations after American enterprise had committed literally billions of dollars in overseas investment at the urging of deliberate U.S. Government policy over many, many years.

Thus, the gross-up proposal as contained in H.R. 10650 is fallacious in principle, inequitable in result, violative of treaty obligations, and dangerous in its economic implications with respect to America's role in international trade.

CRITICISM OF THE CONTROLLED FOREIGN CORPORATION PROPOSAL

Of the many provisions of H.R. 10650 that would operate to destroy American shareholder ownership of overseas subsidiary corporations, the most dangerous and far reaching is the proposal contained in section 13 of the bill dealing with so-called controlled foreign corporations.

This proposal would impose a variety of punitive new tax burdens on American shareholders holding as little as 10 percent of an overseas corporation. As has been previously explained, this tax change would impose a U.S. tax currently on U.S. shareholders with respect to income not received from a foreign corporation; income which may never be received; income which may disappear in the form of normal business losses.

An examination of the implications of the controlled foreign corporation proposal make it all too clear that the express meaning and implicit policy of the provision are—

(1) To tax currently major portions of the current income of legally independent foreign corporations; corporations whose principal offense is that they are wholly or partly American controlled and successful.

(2) To destroy effective American enterprise competitive participation in world trade at the very time the administration is urging the Congress to grant new tariff-cutting authority to the Executive exposing further our American markets to foreign-owned competitors.

(3) To make it a Federal tax offense for American interests to be other than bare minority shareholders in a foreign business. Presumably voting control would have to be surrendered to non-Americans to avoid the punitive tax rules.

(4) To make absolutely no distinction, in deliberately intended punitive effect, between the tax-evasion-type of foreign "paper" company and the legitimate U.S. overseas business company. The tax is to be imposed on U.S. shareholders in all controlled foreign corporations.

(5) To make it a Federal tax offense for an American controlled overseas corporation which is principally engaged in manufacturing or marketing to have even a small element of income stemming from patents, copyrights, and "exclusive" processes and formulas.

(6) To use baseless tax rules to penalize American overseas companies having income in the categories of interest, dividends, or rents. For example, renting out surplus office space or plant facility is obviously good business but under this proposal it would be tantamount to attempted tax evasion.

(7) To punish U.S. shareholders of foreign corporations even through State taxation. Many States have adopted tax rules which automatically follow Federal tax law. If this punitive provision of H.R. 10650 becomes law, each U.S. shareholder in a foreign corporation must also become a taxpayer at the State level under the same weird rules because of the interrelationship of the Federal and State tax laws.

(8) To impose on the normal commercial transactions of American controlled overseas companies a myriad of artificial tax and accounting complexities, accompanied by punitive tax penalties on U.S. shareholders for any company "transgressions" of these incomprehensible, unreal complexities.

(9) To tax currently to the U.S. shareholder the income of a foreign corporation—a tax which is clearly unconstitutional under existing decisions of the U.S. Supreme Court as shown by the opinion of the staff of the Joint Committee on Internal Revenue Taxation printed on page 311 of the House hearings. This new law is to be enacted on the curious expectation that after some years of uncertainty the Supreme Court will reverse its long-standing decisions and validate such a tax law.

(10) To deliberately, by the unilateral action of a statute, nullify, abridge and violate a great many existing income tax treaties to which the United States is a party. See, also, section 21 of the bill.

(11) To impose specific Federal tax punishment for the business offense of diversifying the overseas business operation. A simple example: It will now be a tax offense for an American controlled overseas company in the paper business to engage newly in the plastics business.

(12) Although the administration has been pushing for this tax revision for U.S.-controlled overseas corporations by saying that this is necessary to achieve "equality," "equity," and "neutrality," not a one of these desirable qualities is to be found in these provisions of the bill. A simple example: U.S. shareholders are to be currently taxed on business income of the overseas corporations, but are NOT, repeat NOT, to be allowed any deductions for losses stemming from the same businesses, nor any loss carryovers. Domestic taxpayers are allowed to deduct business losses and are allowed loss carryovers. Equity, equality,

and neutrality as to U.S.-controlled overseas companies is not extended that far under this bill.

The entire atmosphere of section 13 is that of wielding the Federal police power, using the tax system as the baton. But there is no more tax avoidance or evasion in the case of American overseas business than the small fringe that has always existed as to domestic business. The Internal Revenue Service has the tools under existing law to successfully combat any abuses.

The Treasury recommendation is blind to the fact that to the extent an American-owned foreign subsidiary can operate abroad in a way to reduce the taxes paid to foreign countries, the tax money saved is largely saved for the U.S. Treasury. It seems inevitable that the Treasury-proposed tax action against U.S. shareholders of controlled foreign corporations will result in increasing the foreign tax burdens imposed by foreign countries on such enterprise.

The controlled foreign corporation recommendation of the Treasury Department as provided in section 13 of the bill would largely destroy overseas subsidiary operations controlled by American shareholders with new tax rules that are akin to the type of tax sanctions used to combat tax fraud and evasion. Thus, U.S. shareholders of a controlled overseas business stand indicted of improper business practices and illegal tax policies because they successfully sought a proper role in international commerce as urged by the U.S. Government.

CONCLUSION

The Treasury proposals to change the tax rules for doing business abroad will unreasonably penalize those business entities on which America relies to perform vital and enduring foreign policy objectives. Such an approach would make U.S. business activity abroad less welcome and would encourage foreign nations to impose discriminatory taxes on foreign subsidiaries of American corporations. These consequences are contrary to our international commitments and to our national interest. The Treasury approach overlooks the fact that investment by U.S. business abroad has stimulated the purchase of goods and services from the United States and has enabled our free enterprise system to make a major contribution to America's preeminence in international affairs.

This memorandum has highlighted some of the impact that the Treasury's tax proposals affecting American foreign business endeavors will have in terms of economic consequence at home and abroad as well as pointing out some of the dangerous implications the proposals have in the area of international political affairs. Our national tax policy must not be based on unwise and unjustifiable expedients seeking a piecemeal reform of our Federal tax structure which may give rise to widespread and irreparable damage to our economic well-being. The excellence of our American free enterprise system and the urgent needs of our economy require that we avoid tinkering with our Federal tax structure.

While in beginning these separate views it was my purpose to discuss only the gross-up and controlled foreign corporations provisions of H.R. 10650, it may be an appropriate addendum to close by observing that the entire bill is filled with definitional problems, unanswered or conflicting policy questions, and promises of litigation for years to

come. Examples of such shortcomings are found in phrases and expressions never before having meaning in tax law, uncertain definitions of property and income concepts, and the unguided delegation of authority to the Secretary or his delegate. We find in this tax bill changes in tax liability that are actually retroactive to March 1, 1913, and even before; this is the clear operative effect of section 16. We find in this tax bill—a bill being urged by the Treasury Department—a revenue loss of more than \$1 billion in fiscal year 1963. We find in this bill an increase in the cost of American enterprise doing business abroad at the very time we are being urged to make it less costly for foreign producers to do business in our domestic markets.

I respectfully submit to my colleagues that unwise tax policy should not impede American free enterprise and thus radically cut down the American share of world commerce for which Iron Curtain countries compete.

There are many reasons why H.R. 10650 should be defeated; the poorly thought out foreign income proposals are important among those reasons.

THOMAS B. CURTIS.



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 - (e) Repeal of exemption from communications and transportation of persons taxes.
 - (f) Effective dates.
- Sec. 9. Distributions by foreign trusts.
 - (a) Definitions.
 - (b) Accumulation distributions of foreign trusts.

- (c) Allocation of accumulation distributions to preceding years.
- (d) Amounts treated as received in prior years.
- (e) Special rules for foreign trusts.
- (f) Information returns with respect to foreign trusts.
- (g) Failure to file information returns.
- (h) United States person defined.
- (i) Technical amendments.
- (j) Effective date.

Sec. 10. Mutual insurance companies (other than life, marine, and certain fire insurance companies), etc.

- (a) Imposition of tax.
- (b) Taxable investment income.
- (c) Statutory underwriting income or loss.
- (d) Mutual fire insurance companies operating on basis of premium deposits.
- (e) Election of certain mutual companies to be taxed on total income.
- (f) Technical amendments, etc.
- (g) Effective date.

Sec. 11. Domestic corporations receiving dividends from foreign corporations.

- (a) Entire amount of foreign tax to be taken into account.
- (b) Inclusion in gross income of amount equal to taxes deemed paid.
- (c) Determination of source of dividends received from certain foreign corporations.
- (d) Repeal of section 902(d).
- (e) Technical amendments.
- (f) Effective date.

Sec. 12. Earned income from sources without the United States.

- (a) Limitation on amount and type of income excluded.
- (b) Computation of employees' contributions.
- (c) Effective date.

Sec. 13. Controlled foreign corporations.

- (a) In general.
- (b) Technical and clerical amendments.
- (c) Effective date.

Sec. 14. Gain from dispositions of certain depreciable property.

- (a) In general.
- (b) Change in method of depreciation.
- (c) Salvage value of personal property.
- (d) Special rule for charitable contributions of section 1245 property.
- (e) Technical amendments.
- (f) Effective date.

Sec. 15. Foreign investment companies.

- (a) Treatment of sale of stock of foreign investment companies.
- (b) Conforming amendments.
- (c) Effective date.

Sec. 16. Gain from certain sales or exchanges of stock in certain foreign corporations.

- (a) Treatment of gain from the redemption, cancellation, or sale of stock in certain foreign corporations.
- (b) Clerical amendment.
- (c) Effective date.

Sec. 17. Tax treatment of cooperatives and patrons.

- (a) In general.
- (b) Technical amendments.
- (c) Effective dates.

Sec. 18. Inclusion of foreign real property in gross estate.

- (a) Amendments to include foreign real property.
- (b) Effective date.

Sec. 19. Withholding of income tax at source on interest, dividends, and patronage dividends.

- (a) In general.
- (b) Credits against income tax for tax withheld.
- (c) Interest and dividends paid to nonresident aliens, etc.
- (d) Credit for States and tax-exempt organizations.
- (e) Other technical amendments.
- (f) Effective dates.

Sec. 20. Information with respect to certain foreign entities.

- (a) Information to be furnished by individuals, domestic corporations, etc., with respect to certain foreign corporations.
- (b) Information as to organization or reorganization of foreign corporations and as to acquisitions of their stock.
- (c) Civil penalty for failure to file return.
- (d) Technical amendments.
- (e) Effective date.

Sec. 21. Treaties.

1 (c) AMENDMENT OF 1954 CODE.—Whenever in this
2 Act an amendment or repeal is expressed in terms of an
3 amendment to, or repeal of, a section or other provision,
4 the reference shall be considered to be made to a section or
5 other provision of the Internal Revenue Code of 1954.

6 **SEC. 2. CREDIT FOR INVESTMENT IN CERTAIN DEPRE-**
7 **CIABLE PROPERTY.**

8 (a) ALLOWANCE OF CREDIT.—Part IV of subchapter
9 A of chapter 1 (relating to credits against tax) is amended
10 by redesignating section 38 as section 40 and by inserting
11 after section 37 the following new section:

12 **“SEC. 38. INVESTMENT IN CERTAIN DEPRECIABLE PROP-**
13 **ERTY.**

14 “(a) GENERAL RULE.—There shall be allowed, as a
15 credit against the tax imposed by this chapter, the amount
16 determined under subpart B of this part.

17 “(b) REGULATIONS.—The Secretary or his delegate
18 shall prescribe such regulations as may be necessary to carry
19 out the purposes of this section and subpart B.”

20 (b) RULES FOR COMPUTING CREDIT.—Part IV of sub-

1 chapter A of chapter 1 is amended by adding at the end
2 thereof the following new subpart:

3 **“Subpart B—Rules for Computing Credit for Investment**
4 **in Certain Depreciable Property**

“Sec. 46. Amount of credit.

“Sec. 47. Certain dispositions, etc., of section 38 property.

“Sec. 48. Definitions; special rules.

5 **“SEC. 46. AMOUNT OF CREDIT.**

6 **“(a) DETERMINATION OF AMOUNT.—**

7 **“(1) GENERAL RULE.—**The amount of the credit
8 allowed by section 38 for the taxable year shall be equal
9 to 8 percent of the qualified investment (as defined in
10 subsection (c)).

11 **“(2) LIMITATION BASED ON AMOUNT OF TAX.—**
12 Notwithstanding paragraph (1), the credit allowed by
13 section 38 for the taxable year shall not exceed—

14 **“(A)** so much of the liability for tax for the
15 taxable year as does not exceed \$100,000, plus

16 **“(B)** 50 percent of so much of the liability
17 for tax for the taxable year as exceeds \$100,000.

18 **“(3) LIABILITY FOR TAX.—**For purposes of para-
19 graph (2), the liability for tax for the taxable year shall
20 be the tax imposed by this chapter for such year,
21 reduced by the sum of the credits allowable under—

22 **“(A)** section 33 (relating to foreign tax
23 credit),

“(B) section 34 (relating to dividends received by individuals),

“(C) section 35 (relating to partially tax-exempt interest), and

“(D) section 37 (relating to retirement income).

For purposes of this paragraph, any tax imposed for the taxable year by section 531 (relating to accumulated earnings tax) or by section 541 (relating to personal holding company tax) shall not be considered tax imposed by this chapter for such year.

“(4) MARRIED INDIVIDUALS.—In the case of a husband or wife who files a separate return, the amount specified under subparagraphs (A) and (B) of paragraph (2) shall be \$50,000 in lieu of \$100,000. This paragraph shall not apply if the spouse of the taxpayer has no qualified investment for, and no unused credit carryover to, the taxable year of such spouse which ends within or with the taxpayer's taxable year.

“(5) AFFILIATED GROUPS.—In the case of an affiliated group, the \$100,000 amount specified under subparagraphs (A) and (B) of paragraph (2) shall be reduced for each member of the group by apportioning \$100,000 among the members of such group in such manner as the Secretary or his delegate shall by regula-

1 tions prescribe. For purposes of the preceding sentence,
2 the term 'affiliated group' has the meaning assigned to
3 such term by section 1504 (a), except that all corpora-
4 tions shall be treated as includible corporations (with-
5 out any exclusion under section 1504 (b)).

6 “(b) 5-YEAR CARRYOVER OF UNUSED CREDITS.—

7 “(1) ALLOWANCE OF CREDIT.—If the amount of
8 the credit determined under subsection (a) (1) for any
9 taxable year exceeds the limitation provided by subsec-
10 tion (a) (2) for such taxable year (hereinafter in this
11 subsection referred to as 'unused credit year'), such
12 excess shall be added to the amount allowable as a credit
13 by section 38 for each of the 5 succeeding taxable years
14 to the extent not taken into account for taxable years
15 intervening between the unused credit year and such
16 succeeding taxable year.

17 “(2) LIMITATION.—The amount of the unused
18 credit which may be added under paragraph (1) for any
19 succeeding taxable year shall not exceed the amount by
20 which the limitation provided by subsection (a) (2) for
21 such taxable year exceeds the sum of—

22 “(A) the credit allowable under subsection
23 (a) (1) for such taxable year, and

24 “(B) the amounts which, by reason of this
25 subsection, are added to the amount allowable for

such taxable year and attributable to taxable years preceding the unused credit year.

“(c) QUALIFIED INVESTMENT.—

“(1) IN GENERAL.—For purposes of this subpart, the term ‘qualified investment’ means, with respect to any taxable year, the aggregate of—

“(A) the applicable percentage of the basis of each new section 38 property (as defined in section 48 (b)) placed in service by the taxpayer during such taxable year, plus

“(B) the applicable percentage of the cost of each used section 38 property (as defined in section 48 (c) (1)) placed in service by the taxpayer during such taxable year.

“(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the applicable percentage for any property shall be determined under the following table:

“If the useful life is—	The applicable percentage is—
4 years or more but less than 6 years-----	33½
6 years or more but less than 8 years-----	66½
8 years or more-----	100

For purposes of this paragraph, the useful life of any property shall be determined as of the time such property is placed in service by the taxpayer.

1 “(3) PUBLIC UTILITY PROPERTY.—

2 “(A) In the case of section 38 property which
3 is public utility property, the amount of the qualified
4 investment shall be 50 percent of the amount deter-
5 mined under paragraph (1).

6 “(B) For purposes of subparagraph (A), the
7 term ‘public utility property’ means property used
8 predominantly in the trade or business of the fur-
9 nishing or sale of—

10 “(i) electrical energy, water, or sewage
11 disposal services,

12 “(ii) gas through a local distribution sys-
13 tem,

14 “(iii) telephone service, or

15 “(iv) telegraph service by means of do-
16 mestic telegraph operations (as defined in
17 section 222 (a) (5) of the Communications Act
18 of 1934, as amended; 47 U.S.C., sec. 222 (a)
19 (5)),

20 if the rates for such furnishing or sale, as the case
21 may be, have been established or approved by a
22 State or political subdivision thereof, by an agency
23 or instrumentality of the United States, or by a
24 public service or public utility commission or other

similar body of any State or political subdivision thereof.

“(d) LIMITATIONS WITH RESPECT TO CERTAIN PERSONS.—

“(1) IN GENERAL.—In the case of—

“(A) an organization to which section 593 applies,

“(B) a regulated investment company or a real estate investment trust subject to taxation under subchapter M (sec. 851 and following), and

“(C) a cooperative organization described in section 1381 (a),

the qualified investment and the \$100,000 amount specified under subparagraphs (A) and (B) of subsection (a) (2) shall equal such person's ratable share of such items.

“(2) RATABLE SHARE.—For purposes of paragraph (1), the ratable share of any person for any taxable year of the items described therein shall be—

“(A) in the case of an organization referred to in paragraph (1) (A), 50 percent thereof,

“(B) in the case of a regulated investment company or a real estate investment trust, the ratio (i) the numerator of which is its taxable income and

1 (ii) the denominator of which is its taxable income
 2 computed without regard to the deduction for divi-
 3 dends paid provided by section 852 (b) (2) (D) or
 4 857 (b) (2) (C), as the case may be, and

5 “(C) in the case of a cooperative organization,
 6 the ratio (i) the numerator of which is its taxable
 7 income and (ii) the denominator of which is its
 8 taxable income increased by amounts to which
 9 section 1382 (b) or (c) applies and similar amounts
 10 the tax treatment of which is determined without
 11 regard to subchapter T (sec. 1381 and following).

12 For purposes of subparagraph (B) of the preceding
 13 sentence, the term ‘taxable income’ means in the case of
 14 a regulated investment company its investment company
 15 taxable income (within the meaning of section
 16 852 (b) (2)), and in the case of a real estate invest-
 17 ment trust its real estate investment trust taxable in-
 18 come (within the meaning of section 857 (b) (2)).

19 **“SEC. 47. CERTAIN DISPOSITIONS, ETC., OF SECTION 38**
 20 **PROPERTY.**

21 “(a) **GENERAL RULE.**—Under regulations prescribed
 22 by the Secretary or his delegate—

23 “(1) **EARLY DISPOSITION, ETC.**—If during any tax-
 24 able year any property is disposed of, or otherwise

1 ceases to be section 38 property with respect to the tax-
2 payer, before the close of the useful life which was taken
3 into account in computing the credit under section 38,
4 then the tax under this chapter for such taxable year
5 shall be increased by an amount equal to the aggregate
6 decrease in the credits allowed under section 38 for all
7 prior taxable years which would have resulted solely
8 from substituting, in determining qualified investment,
9 for such useful life the period beginning with the time
10 such property was placed in service by the taxpayer and
11 ending with the time such property ceased to be section
12 38 property.

13 “(2) PROPERTY BECOMES PUBLIC UTILITY PROP-
14 erty.—If during any taxable year any property taken
15 into account in determining qualified investment becomes
16 public utility property (within the meaning of section
17 46 (c) (3) (B)), then the tax under this chapter for
18 such taxable year shall be increased by an amount equal
19 to the aggregate decrease in the credits allowed under
20 section 38 for all prior taxable years which would have
21 resulted solely from treating the property, for purposes
22 of determining qualified investment, as public utility
23 property (after giving due regard to the period before
24 such change in use) . If the application of this paragraph

1 to any property is followed by the application of para-
2 graph (1) to such property, proper adjustment shall be
3 made in applying paragraph (1).

4 “(3) CARRYOVERS ADJUSTED.—In the case of
5 any cessation described in paragraph (1) or any
6 change in use described in paragraph (2), the carry-
7 overs under section 46(b) shall be adjusted by reason
8 of such cessation (or change in use).

9 “(b) SECTION NOT TO APPLY IN CERTAIN CASES.—
10 Subsection (a) shall not apply to—

11 “(1) a transfer by reason of death, or

12 “(2) a transaction to which section 381(a) applies.

13 For purposes of subsection (a), property shall not be treated
14 as ceasing to be section 38 property with respect to the tax-
15 payer by reason of a mere change in the form of conducting
16 the trade or business so long as the property is retained in
17 such trade or business as section 38 property and the tax-
18 payer retains a substantial interest in such trade or business.

19 “(c) SPECIAL RULE.—Any increase in tax under sub-
20 section (a) shall not be treated as tax imposed by this
21 chapter for purposes of determining the amount of any credit
22 allowable under subpart A.

1 "SEC. 48. DEFINITIONS; SPECIAL RULES.

2 "(a) SECTION 38 PROPERTY.—

3 "(1) IN GENERAL.—Except as provided in this
4 subsection, the term 'section 38 property' means—

5 "(A) tangible personal property, or

6 "(B) other tangible property (not including
7 a building and its structural components) but only
8 if such property—

9 "(i) is used as an integral part of manu-
10 facturing, production, or extraction or of fur-
11 nishing transportation, communications, elec-
12 trical energy, gas, water, or sewage disposal
13 services, or

14 "(ii) constitutes a research or storage fa-
15 cility used in connection with any of the activi-
16 ties referred to in clause (i).

17 Such term includes only property with respect to which
18 depreciation (or amortization in lieu of depreciation) is
19 allowable and having a useful life (determined as of
20 the time such property is placed in service) of 4 years
21 or more.

1 “(2) PROPERTY USED OUTSIDE THE UNITED
2 STATES.—

3 “(A) IN GENERAL.—Except as provided in
4 subparagraph (B), the term ‘section 38 property’
5 does not include property which is used predomi-
6 nantly outside the United States.

7 “(B) EXCEPTIONS.—Subparagraph (A) shall
8 not apply to—

9 “(i) any aircraft which is registered by
10 the Administrator of the Federal Aviation
11 Agency and which is operated to and from the
12 United States;

13 “(ii) rolling stock, of a domestic railroad
14 corporation subject to part I of the Interstate
15 Commerce Act, which is used within and with-
16 out the United States;

17 “(iii) any vessel documented under the
18 laws of the United States which is operated in
19 the foreign or domestic commerce of the United
20 States;

21 “(iv) any motor vehicle of a United States
22 person (as defined in section 7701 (a) (30))
23 which is operated to and from the United
24 States;

25 “(v) any container of a United States

1 person which is used in the transportation of
2 property to and from the United States; and

3 “(vi) any property (other than a vessel
4 or an aircraft) of a United States person which
5 is used for the purpose of exploring for, de-
6 veloping, removing, or transporting resources
7 from the outer Continental Shelf (within the
8 meaning of section 2 of the Outer Continental
9 Shelf Lands Act, as amended and supple-
10 mented; 43 U.S.C., sec. 1331).

11 “(3) PROPERTY USED FOR LODGING.—Property
12 which is used predominantly to furnish lodging or in
13 connection with the furnishing of lodging shall not be
14 treated as section 38 property. The preceding sentence
15 shall not apply to—

16 “(A) nonlodging commercial facilities which
17 are available to persons not using the lodging facili-
18 ties on the same basis as they are available to per-
19 sons using the lodging facilities, and

20 “(B) property used by a hotel or motel in con-
21 nection with the trade or business of furnishing
22 lodging where the predominant portion of the ac-
23 commodations is used by transients.

24 “(4) PROPERTY USED BY CERTAIN TAX-EXEMPT

1 ORGANIZATIONS.—Property used by an organization
2 (other than a cooperative described in section 521)
3 which is exempt from the tax imposed by this chapter
4 shall be treated as section 38 property only if such
5 property is used predominantly in an unrelated trade or
6 business the income of which is subject to tax under
7 section 511.

8 “(5) PROPERTY USED BY GOVERNMENTAL
9 UNITS.—Property used by the United States, any State
10 or political subdivision thereof, any international organ-
11 ization, or any agency or instrumentality of any of the
12 foregoing shall not be treated as section 38 property.

13 “(b) NEW SECTION 38 PROPERTY.—For purposes of
14 this subpart, the term ‘new section 38 property’ means sec-
15 tion 38 property—

16 “(1) the construction, reconstruction, or erection
17 of which is completed by the taxpayer after December
18 31, 1961, or

19 “(2) acquired after December 31, 1961, if the
20 original use of such property commences with the tax-
21 payer and commences after such date.

22 In applying section 46(c)(1)(A) in the case of property
23 described in paragraph (1), there shall be taken into account

1 only that portion of the basis which is properly attributable
2 to construction, reconstruction, or erection after December
3 31, 1961.

4 “(c) USED SECTION 38 PROPERTY.—

5 “(1) IN GENERAL.—For purposes of this subpart,
6 the term ‘used section 38 property’ means section 38
7 property acquired by purchase after December 31, 1961,
8 which is not new section 38 property. Property shall
9 not be treated as ‘used section 38 property’ if, after its
10 acquisition by the taxpayer, it is used by a person who
11 used such property before such acquisition (or by a
12 person who bears a relationship described in section
13 179(d)(2)(A) or (B) to a person who used such
14 property before such acquisition).

15 “(2) DOLLAR LIMITATION.—

16 “(A) IN GENERAL.—The cost of used section
17 38 property taken into account under section 46
18 (c)(1)(B) for any taxable year shall not exceed
19 \$50,000. If such cost exceeds \$50,000, the tax-
20 payer shall select (at such time and in such manner
21 as the Secretary or his delegate shall by regulations
22 prescribe) the items to be taken into account, but
23 only to the extent of an aggregate cost of \$50,000.

1 Such a selection, once made, may be changed only
2 in the manner, and to the extent, provided by such
3 regulations.

4 “(B) MARRIED INDIVIDUALS.—In the case of
5 a husband or wife who files a separate return, the
6 limitation under subparagraph (A) shall be
7 \$25,000 in lieu of \$50,000. This subparagraph
8 shall not apply if the spouse of the taxpayer has no
9 used section 38 property which may be taken into
10 account as qualified investment for the taxable year
11 of such spouse which ends within or with the tax-
12 payer’s taxable year.

13 “(C) AFFILIATED GROUPS.—In the case of an
14 affiliated group, the \$50,000 amount specified under
15 subparagraph (A) shall be reduced for each mem-
16 ber of the group by apportioning \$50,000 among
17 the members of such group in accordance with their
18 respective amounts of used section 38 property
19 which may be taken into account.

20 “(D) PARTNERSHIPS.—In the case of a part-
21 nership, the limitation contained in subparagraph
22 (A) shall apply with respect to the partnership and
23 with respect to each partner.

24 “(3) DEFINITIONS.—For purposes of this sub-
25 section—

1 “(A) PURCHASE.—The term ‘purchase’ has
2 the meaning assigned to such term by section
3 179 (d) (2) .

4 “(B) COST.—The cost of used section 38
5 property does not include so much of the basis of
6 such property as is determined by reference to the
7 adjusted basis of other property held at any time by
8 the person acquiring such property. If property is
9 disposed of and used section 38 property similar or
10 related in service or use is acquired as a replace-
11 ment therefor in a transaction to which the pre-
12 ceding sentence does not apply, the cost of the used
13 section 38 property acquired shall be its basis re-
14 duced by the adjusted basis of the property re-
15 placed. The cost of used section 38 property shall
16 not be reduced with respect to the adjusted basis of
17 any property disposed of if, by reason of section 47,
18 such disposition involved an increase of tax or
19 a reduction of the unused credit carryovers described
20 in section 46 (b) .

21 “(C) AFFILIATED GROUP.—The term ‘affili-
22 ated group’ has the meaning assigned to such term
23 by section 1504 (a) , except that—

24 “(i) the phrase ‘more than 50 percent’
25 shall be substituted for the phrase ‘at least 80

1 percent' each place it appears in section
2 1504 (a), and

3 “(ii) all corporations shall be treated as
4 includible corporations (without any exclusion
5 under section 1504 (b)).

6 “(d) CERTAIN LEASED PROPERTY.—A person (other
7 than a person referred to in section 46 (d)) engaged in the
8 business of leasing property may (at such time, in such
9 manner, and subject to such conditions as are provided by
10 regulations prescribed by the Secretary or his delegate)
11 elect with respect to any new section 38 property to treat
12 the lessee as having acquired such property for an amount
13 equal to—

14 “(1) if such property was constructed by the lessor
15 (or by a corporation which controls or is controlled by
16 the lessor within the meaning of section 368 (c)), the
17 fair market value of such property, or

18 “(2) if paragraph (1) does not apply, the basis
19 of such property to the lessor.

20 The election provided by the preceding sentence may be
21 made only with respect to property which would be new
22 section 38 property if acquired by the lessee. For purposes
23 of the preceding sentence and section 46 (c) , the useful life
24 of property in the hands of the lessee is the useful life of such
25 property in the hands of the lessor. If a lessor makes the

1 election provided by this subsection with respect to any
2 property, the lessee shall be treated for all purposes of this
3 subpart as having acquired such property.

4 “(e) SUBCHAPTER S CORPORATIONS.—In the case of
5 an electing small business corporation (as defined in section
6 1371)—

7 “(1) the qualified investment for each taxable year
8 shall be apportioned pro rata among the persons who
9 are shareholders of such corporation on the last day of
10 such taxable year; and

11 “(2) any person to whom any investment has been
12 apportioned under paragraph (1) shall be treated (for
13 purposes of this subpart) as the taxpayer with respect
14 to such investment, and such investment shall not (by
15 reason of such apportionment) lose its character as an
16 investment in new section 38 property or used section
17 38 property, as the case may be.

18 “(f) ESTATES AND TRUSTS.—In the case of an estate
19 or trust—

20 “(1) the qualified investment for any taxable year
21 shall be apportioned between the estate or trust and the
22 beneficiaries on the basis of the income of the estate or
23 trust allocable to each,

24 “(2) any beneficiary to whom any investment has
25 been apportioned under paragraph (1) shall be treated

1 (for purposes of this subpart) as the taxpayer with re-
 2 spect to such investment, and such investment shall not
 3 (by reason of such apportionment) lose its character as
 4 an investment in new section 38 property or used section
 5 38 property, as the case may be, and

6 “(3) the \$100,000 amount specified under sub-
 7 paragraphs (A) and (B) of section 46(a)(2) ap-
 8 plicable to such estate or trust shall be reduced to an
 9 amount which bears the same ratio to \$100,000 as the
 10 amount of the qualified investment allocated to the
 11 estate or trust under paragraph (1) bears to the entire
 12 amount of the qualified investment.

13 “(g) CROSS REFERENCE.—

“For application of this subpart to certain acquiring corporations, see section 381(c)(23).”

14 (c) CERTAIN CORPORATE ACQUISITIONS.—Section
 15 381(c) (relating to items taken into account in certain
 16 corporate acquisitions) is amended by adding at the end
 17 thereof the following new paragraph:

18 “(23) CREDIT UNDER SECTION 38 FOR INVEST-
 19 MENT IN CERTAIN DEPRECIABLE PROPERTY.—The ac-
 20 quiring corporation shall take into account (to the ex-
 21 tent proper to carry out the purposes of this section and
 22 section 38, and under such regulations as may be pre-
 23 scribed by the Secretary or his delegate) the items re-

quired to be taken into account for purposes of section 38 in respect of the distributor or transferor corporation."

(d) CLERICAL AMENDMENT.—Part IV of subchapter A of chapter 1 is amended by inserting after the heading and before the table of sections the following:

"Subpart A. Credits allowable.

"Subpart B. Rules for computing credit for investment in certain depreciable property.

"Subpart A—Credits Allowable"

(e) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years ending after December 31, 1961.

SEC. 3. APPEARANCES, ETC., WITH RESPECT TO LEGISLATION.

(a) IN GENERAL.—Section 162 (relating to trade or business expenses) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) APPEARANCES, ETC., WITH RESPECT TO LEGISLATION.—

"(1) IN GENERAL.—The deduction allowed by subsection (a) shall include all the ordinary and necessary expenses (including, but not limited to, traveling expenses described in subsection (a) (2) and the cost

1 of preparing testimony) paid or incurred during the tax-
2 able year in carrying on any trade or business—

3 “(A) in direct connection with appearances
4 before, submission of statements to, or sending com-
5 munications to, the committees, or individual mem-
6 bers, of Congress or of any legislative body of a
7 State, a possession of the United States, or a politi-
8 cal subdivision of any of the foregoing with respect
9 to legislation or proposed legislation of direct inter-
10 est to the taxpayer, or

11 “(B) in direct connection with communication
12 of information between the taxpayer and an organ-
13 ization of which he is a member with respect to
14 legislation or proposed legislation of direct interest
15 to the taxpayer and to such organization,

16 and that portion of the dues so paid or incurred with
17 respect to any organization of which the taxpayer is a
18 member which is attributable to the expenses of the
19 activities described in subparagraphs (A) and (B)
20 carried on by such organization.

21 “(2) LIMITATION.—The provisions of paragraph
22 (1) shall not be construed as allowing the deduction of
23 any amount paid or incurred (whether by way of con-
24 tribution, gift, or otherwise) —

25 “(A) for participation in, or intervention in,

any political campaign on behalf of any candidate
for public office, or

“(B) in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums.”

(b) **EFFECTIVE DATE.**—The amendments made by this section shall apply to taxable years beginning after December 31, 1962.

**SEC. 4. DISALLOWANCE OF CERTAIN ENTERTAINMENT,
ETC., EXPENSES.**

(a) **DENIAL OF DEDUCTION.**—

(1) Part IX of subchapter B of chapter 1 (relating to items not deductible in computing taxable income) is amended by adding at the end thereof the following new section:

**“SEC. 274. DISALLOWANCE OF CERTAIN ENTERTAINMENT,
ETC., EXPENSES.**

“(a) ENTERTAINMENT, AMUSEMENT, OR RECREATION.—

“(1) IN GENERAL.—No deduction otherwise allowable under this chapter shall be allowed for any item—

“(A) ACTIVITY.—With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless

1 the taxpayer establishes that the item was directly
2 related to the active conduct of the taxpayer's trade
3 or business, or

4 “(B) FACILITY.—With respect to a facility
5 used in connection with an activity referred to in
6 subparagraph (A), unless the taxpayer establishes
7 that the facility was used primarily for the further-
8 ance of the taxpayer's trade or business and that the
9 item was directly related to the active conduct of
10 such trade or business,

11 and such deduction shall in no event exceed the portion
12 of such item directly related to the active conduct of the
13 taxpayer's trade or business.

14 “(2) SPECIAL RULES.—For purposes of applying
15 paragraph (1) —

16 “(A) Dues or fees to any social, athletic, or
17 sporting club or organization shall be treated as
18 items with respect to facilities.

19 “(B) An activity described in section 212
20 shall be treated as a trade or business.

21 “(b) GIFTS.—

22 “(1) LIMITATION.—No deduction shall be allowed
23 under section 162 or section 212 for any expense for
24 gifts made directly or indirectly to any individual to the
25 extent that such expense, when added to prior expenses

1 of the taxpayer for gifts made to such individual during
2 the same taxable year, exceeds \$25. For purposes of
3 this section, the term 'gift' means any item excludable
4 from gross income of the recipient under section 102
5 which is not excludable from his gross income under any
6 other provision of this chapter.

7 “(2) SPECIAL RULES.—

8 “(A) In the case of a gift by a partnership, the
9 limitation contained in paragraph (1) shall apply
10 to the partnership as well as to each member thereof.

11 “(B) For purposes of paragraph (1), a hus-
12 band and wife shall be treated as one taxpayer.

13 “(c) SUBSTANTIATION REQUIRED.—No deduction shall
14 be allowed—

15 “(1) under section 162 or 212 for any traveling
16 expense (including meals and lodging while away from
17 home),

18 “(2) for any item with respect to an activity which
19 is of a type generally considered to constitute entertain-
20 ment, amusement, or recreation, or with respect to a
21 facility used in connection with such an activity, or

22 “(3) for any expense for gifts,

23 unless the taxpayer substantiates by adequate records or by
24 sufficient evidence corroborating his own statement (A) the
25 amount of such expense or other item, (B) the time and

1 place of the travel, entertainment, amusement, recreation, or
2 use of the facility, or the date and description of the gift, (C)
3 the business purpose of the expense or other item, and (D)
4 the business relationship to the taxpayer of persons enter-
5 tained, using the facility, or receiving the gift. The Secre-
6 tary or his delegate may by regulations provide that some
7 or all of the requirements of the preceding sentence shall not
8 apply in the case of an expense which does not exceed an
9 amount prescribed pursuant to such regulations.

10 “(d) SPECIFIC EXCEPTIONS TO APPLICATION OF SUB-
11 SECTION (a).—Subsection (a) shall not apply to—

12 “(1) BUSINESS MEALS.—Expenses for food and
13 beverages furnished to any individual under circum-
14 stances which (taking into account the surroundings in
15 which furnished, the taxpayer’s trade, business, or in-
16 come-producing activity and the relationship to such
17 trade, business, or activity of the persons to whom the
18 food and beverages are furnished) are of a type generally
19 considered to be conducive to a business discussion.

20 “(2) FOOD AND BEVERAGES FOR EMPLOYEES.—
21 Expenses for food and beverages (and facilities used
22 in connection therewith) furnished on the business prem-
23 ises of the taxpayer primarily for his employees.

24 “(3) EXPENSES TREATED AS COMPENSATION.—
25 Expenses for goods, services, and facilities, to the ex-

1 tent that the expenses are treated by the taxpayer, with
2 respect to the recipient of the entertainment, amusement,
3 or recreation, as compensation to an employee on the
4 taxpayer's return of tax under this chapter and as wages
5 to such employee for purposes of chapter 24 (relating
6 to withholding of income tax at source on wages) .

7 “(4) REIMBURSED EXPENSES.—Expenses paid or
8 incurred by the taxpayer, in connection with the per-
9 formance by him of services for another person
10 (whether or not such other person is his employer),
11 under a reimbursement or other expense allowance
12 arrangement with such other person, but this para-
13 graph shall apply—

14 “(A) where the services are performed for
15 an employer, only if the employer has not treated
16 such expenses in the manner provided in paragraph
17 (3), or

18 “(B) where the services are performed for a
19 person other than an employer, only if the tax-
20 payer accounts (to the extent provided by sub-
21 section (c)) to such person.

22 “(5) RECREATIONAL, ETC., EXPENSES FOR EM-
23 PLOYEES.—Expenses for recreational, social, or similar
24 activities (including facilities therefor) primarily for
25 the benefit of employees (other than employees who

1 are officers, shareholders or other owners, or highly
2 compensated employees). For purposes of this para-
3 graph, an individual owning less than a 10-percent in-
4 terest in the taxpayer's trade or business shall not be
5 considered a shareholder or other owner, and for such
6 purposes an individual shall be treated as owning any
7 interest owned by a member of his family (within the
8 meaning of section 267 (c) (4)).

9 “(6) EMPLOYEE AND STOCKHOLDER BUSINESS
10 MEETINGS.—Expenses directly related to business meet-
11 ings of employees or stockholders.

12 “(7) MEETINGS OF BUSINESS LEAGUES, ETC.—
13 Expenses directly related and necessary to attendance at
14 a business meeting or convention of any organization
15 described in section 501 (c) (6) (relating to business
16 leagues, chambers of commerce, real estate boards, and
17 boards of trade) and exempt from taxation under section
18 501 (a) .

19 “(8) ITEMS AVAILABLE TO PUBLIC.—Expenses for
20 goods, services, and facilities made available by the tax-
21 payer to the general public.

22 “(9) ENTERTAINMENT SOLD TO CUSTOMERS.—Ex-
23 penses for goods or services (including the use of facili-
24 ties) which are sold by the taxpayer in a bona fide

1 transaction for an adequate and full consideration in
2 money or money's worth.

3 For purposes of this subsection, any item referred to in sub-
4 section (a) shall be treated as an expense.

5 “(e) INTEREST, TAXES, CASUALTY LOSSES, ETC.—

6 This section shall not apply to any deduction allowable to
7 the taxpayer without regard to its connection with his trade
8 or business (or with his income-producing activity). In the
9 case of a taxpayer which is not an individual, the preceding
10 sentence shall be applied as if it were an individual.

11 “(f) TREATMENT OF ENTERTAINMENT, ETC., TYPE

12 FACILITY.—For purposes of this chapter, if deductions are
13 disallowed under subsection (a) with respect to any portion
14 of a facility, such portion shall be treated as an asset which is
15 used for personal, living, and family purposes (and not as
16 an asset used in the trade or business).

17 “(g) REGULATORY AUTHORITY.—The Secretary or his

18 delegate shall prescribe such regulations as he may deem
19 necessary to carry out the purposes of this section, includ-
20 ing regulations prescribing whether subsection (a) or sub-
21 section (b) applies in cases where both such subsections
22 would otherwise apply.”

1 (2) The table of sections for such part IX is amended
2 by adding at the end thereof the following:

 “Sec. 274. Disallowance of certain entertainment, etc., ex-
 penses.”

3 (b) TRAVELING EXPENSES.—Section 162 (a) (2) (re-
4 lating to traveling expenses) is amended by striking out
5 “(including the entire amount expended for meals and lodg-
6 ing)” and inserting in lieu thereof “(including a reasonable
7 allowance for amounts expended for meals and lodging)”.

8 (c) EFFECTIVE DATE.—The amendments made by this
9 section shall apply with respect to taxable years ending after
10 June 30, 1962, but only in respect of periods after such
11 date.

12 **SEC. 5. AMOUNT OF DISTRIBUTION WHERE CERTAIN**
13 **FOREIGN CORPORATIONS DISTRIBUTE PROP-**
14 **ERTY IN KIND.**

15 (a) AMOUNT DISTRIBUTED.—Section 301 (b) (1)
16 (relating to amount distributed to corporate distributees) is
17 amended by adding at the end thereof the following new
18 subparagraph:

19 “(C) CERTAIN CORPORATE DISTRIBUTEES OF
20 FOREIGN CORPORATION.—Notwithstanding subpara-
21 graph (B), if the shareholder is a corporation and
22 the distributing corporation is a foreign corporation,
23 the amount taken into account with respect to

property (other than money) shall be the fair market value of such property; except that if any deduction is allowable under section 245 with respect to such distribution, then the amount taken into account shall be the sum (determined under regulations prescribed by the Secretary or his delegate) of—

“(i) the proportion of the adjusted basis of such property (or, if lower, its fair market value) properly attributable to gross income from sources within the United States, and

“(ii) the proportion of the fair market value of such property properly attributable to gross income from sources without the United States.”

(b) BASIS.—Section 301 (d) (relating to basis of property) is amended by adding at the end thereof the following new paragraph:

“(3) CERTAIN CORPORATE DISTRIBUTEES OF FOREIGN CORPORATION.—In the case of property described in subparagraph (C) of subsection (b) (1), the basis shall be determined by substituting the amount determined under such subparagraph (C) for the amount described in paragraph (2) of this subsection.”

1 (c) DIVIDENDS RECEIVED FROM CERTAIN FOREIGN
2 CORPORATIONS.—

3 (1) Section 245 (relating to dividends received
4 from certain foreign corporations) is amended by add-
5 ing at the end thereof the following new subsection:

6 “(b) PROPERTY DISTRIBUTIONS.—For purposes of sub-
7 section (a), the amount of any distribution of property other
8 than money shall be the amount determined by applying
9 section 301 (b) (1) (B).”

10 (2) Section 245 is amended by striking out “In
11 the case of” and inserting in lieu thereof “(a) GENERAL
12 RULE.—In the case of”.

13 (d) CREDIT FOR FOREIGN TAXES.—Section 902 (a)
14 (relating to credit for foreign taxes) is amended by adding
15 at the end thereof the following new sentence: “For pur-
16 poses of this subsection and subsection (b), the amount of
17 any distribution in property other than money shall be the
18 amount determined by applying section 301 (b) (1) (B).”

19 (e) EFFECTIVE DATE.—The amendments made by this
20 section shall apply to distributions made after December 31,
21 1962.

22 SEC. 6. AMENDMENT OF SECTION 482.

23 (a) IN GENERAL.—Section 482 (relating to allocation
24 of income and deductions among taxpayers) is amended
25 by adding at the end thereof the following new subsection:

1 “(b) SALES AND PURCHASES WITHIN A RELATED
2 GROUP WHICH INCLUDES A FOREIGN ORGANIZATION.—

3 “(1) IN GENERAL.—In applying subsection (a)
4 to sales of tangible property within a group of organiza-
5 tions—

6 “(A) owned or controlled directly or indi-
7 rectly by the same interests, and

8 “(B) at least one of which is a domestic or-
9 ganization and at least one of which is a foreign
10 organization,

11 the Secretary or his delegate may allocate the taxable
12 income of the group arising from such sales in the
13 manner set forth in paragraph (2). This subsection
14 shall not apply with respect to any sale of tangible
15 property for which the taxpayer can establish an arm’s
16 length price (within the meaning of paragraph (4)).

17 “(2) METHODS OF ALLOCATION.—

18 “(A) CONSIDERATION OF CERTAIN FAC-
19 TORS.—Except as provided in subparagraph (B),
20 the allocation referred to in paragraph (1) shall be
21 made by the Secretary or his delegate by taking into
22 consideration that portion of the following factors
23 which is attributable to the United States and that
24 portion thereof which is not attributable to the
25 United States—

1 “(i) assets of the group, to the extent used
2 in the production, distribution, and sale of the
3 property,

4 “(ii) compensation of officers and em-
5 ployees, to the extent attributable to the pro-
6 duction, distribution, and sale of the property,
7 and

8 “(iii) advertising, selling, and sales promo-
9 tion expenses (including technical and servic-
10 ing expenses), to the extent attributable to
11 the property.

12 Such method of allocation may also give considera-
13 tion to other factors, including the special risks (if
14 any) of the market in which the property is sold.

15 “(B) ALTERNATIVE METHODS.—If the tax-
16 payer establishes to the satisfaction of the Secretary
17 or his delegate that an alternative method of alloca-
18 tion clearly reflects the income of each member of
19 the group with respect to the property referred to in
20 paragraph (1), such alternative method shall be
21 used (in lieu of the method provided in subpara-
22 graph (A)).

23 “(3) SPECIAL RULES.—In applying the method
24 of allocation referred to in paragraph (2) (A), the
25 following rules shall be applied:

1 “(A) ADJUSTED BASIS OF ASSETS.—The
2 values to be assigned to the assets referred to in
3 paragraph (2) (A) (i) is their adjusted basis in the
4 hands of the taxpayer or, if such basis is not avail-
5 able in the case of a foreign organization, then their
6 book values, adjusted to approximate their adjusted
7 basis.

8 “(B) INCLUDIBLE ASSETS.—The assets re-
9 ferred to in paragraph (2) (A) (i) include real
10 property and tangible personal property (whether
11 owned or leased by a member of the group), but do
12 not include inventory and stock in trade.

13 “(4) ARM’S LENGTH PRICE DEFINED.—For pur-
14 poses of this subsection, the term ‘arm’s length price’
15 means—

16 “(A) the price at which tangible property sim-
17 ilar or comparable to the property referred to in
18 paragraph (1) generally is or can be sold in trans-
19 actions in the same areas involving unrelated per-
20 sons and made under similar conditions of sale; and

21 “(B) if subparagraph (A) does not apply, the
22 price at which tangible property similar or com-
23 parable to the property referred to in paragraph
24 (1) is sold in the same or other areas under similar
25 circumstances and in transactions involving unre

1 lated persons, with adjustment for material differ-
2 ences in quantity, marketing conditions (including
3 customs duties and transportation costs), and other
4 relevant factors.

5 Subparagraph (B) shall apply only if the adjustment
6 referred to therein is properly determinable.

7 “(5) SALES COMMISSIONS.—The Secretary or his
8 delegate shall by regulation prescribe rules for the allo-
9 cation of commissions arising from sales of tangible
10 property within a group of organizations described in
11 paragraph (1). Such rules shall be consistent with the
12 principles specified in the other paragraphs of this
13 subsection.

14 “(6) GROSSLY INADEQUATE ASSETS, ETC., OUT-
15 SIDE UNITED STATES.—In allocating taxable income
16 under this subsection, no amount shall be allocated to a
17 foreign organization whose assets, personnel, and office
18 and other facilities which are not attributable to the
19 United States are grossly inadequate for its activities
20 outside the United States.

21 “(7) INFORMATION NECESSARY FOR CONSIDERA-
22 TION OF FACTORS.—In the case of any transaction to
23 which paragraph (2) (A.) applies, if—

24 “(A) the information submitted with respect
25 to the group of organizations is insufficient for the

proper application of the method of allocation set forth in the first sentence of such paragraph, and

“(B) upon request of the Secretary or his delegate, such group fails to furnish such additional information with respect to such transaction as may be reasonably supplied,

the Secretary or his delegate may estimate the taxable income arising from such transaction and may allocate such taxable income among the members of the group or to any single member thereof.

“(8) TREATMENT OF FOREIGN TAXES.—

“(A) For purposes of this subsection, taxable income shall be determined without regard to any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States.

“(B) Where the application of this subsection results in a decrease in the taxable income of any foreign organization and an increase in the taxable income of any domestic organization, then any of the taxes referred to in subparagraph (A) paid by such foreign organization and attributable to the taxable income so transferred shall be treated for purposes of this chapter—

1 “(i) as paid by such domestic organiza-
2 tion, and

3 “(ii) as not paid by such foreign organi-
4 zation.”

5 (b) CLERICAL AMENDMENT.—Section 482 is amended
6 by striking out “In any case of two or more organizations”
7 and inserting in lieu thereof the following:

8 “(a) GENERAL RULE.—In the case of two or more
9 organizations”.

10 (c) EFFECTIVE DATE.—The amendments made by
11 this section shall apply with respect to taxable years begin-
12 ning after December 31, 1962.

13 **SEC. 7. DISTRIBUTIONS OF FOREIGN PERSONAL HOLD-**
14 **ING COMPANY INCOME.**

15 (a) DEFINITION OF FOREIGN PERSONAL HOLDING
16 COMPANY.—So much of subsection (a) of section 522 (re-
17 lating to definition of foreign personal holding company) as
18 precedes paragraph (2) is amended to read as follows:

19 “(a) GENERAL RULE.—For purposes of this subtitle,
20 the term ‘foreign personal holding company’ for a taxable
21 year beginning after December 31, 1962, means any for-
22 eign corporation if—

23 “(1) GROSS INCOME REQUIREMENT.—At least 20
24 percent of its gross income (as defined in section 555
25 (a)) for the taxable year is foreign personal holding

company income (as defined in section 553). For purposes of this paragraph, there shall be included in the gross income the amount includible therein as a dividend by reason of the application of section 555 (c) (2) ; and”.

(b) AMOUNT OF UNDISTRIBUTED INCOME.—Subsection (a) of section 556 (relating to undistributed foreign personal holding company income) is amended to read as follows:

“(a) DEFINITION.—For purposes of this part—

“(1) If the foreign personal holding company income of a foreign personal holding company exceeds 80 percent of its gross income, the ‘undistributed foreign personal holding company income’ of such company is its taxable income adjusted in the manner provided in subsection (b), minus the dividends paid deduction (as defined in section 561).

“(2) If the foreign personal holding company income of a foreign personal holding company does not exceed 80 percent of its gross income, the ‘undistributed foreign personal holding company income’ of such company is that amount which bears the same ratio to—

“(A) its taxable income adjusted in the manner provided in subsection (b), minus the dividends paid deduction (as defined in section 561), as

1 “(B) its foreign personal holding company in-
2 come bears to its gross income.”

3 (c) EFFECTIVE DATE.—The amendments made by this
4 section shall apply only in respect of taxable years of
5 foreign corporations beginning after December 31, 1962.

6 **SEC. 8. MUTUAL SAVINGS BANKS, ETC.**

7 (a) RESERVES FOR LOSSES ON LOANS.—Section 593
8 is amended to read as follows:

9 **“SEC. 593. RESERVES FOR LOSSES ON LOANS.**

10 “(a) ORGANIZATIONS TO WHICH SECTION APPLIES.—
11 This section shall apply to any mutual savings bank not
12 having capital stock represented by shares, domestic building
13 and loan association, or cooperative bank without capital
14 stock organized and operated for mutual purposes and with-
15 out profit.

16 “(b) ADDITION TO RESERVES FOR BAD DEBTS.—

17 “(1) IN GENERAL.—For purposes of section 166
18 (c), the reasonable addition for the taxable year to the
19 reserve for bad debts of any taxpayer described in sub-
20 section (a) shall be an amount equal to the sum of—

21 “(A) the amount determined under section
22 166(c) to be a reasonable addition to the reserve
23 for losses on nonqualifying loans, plus

24 “(B) the amount determined by the taxpayer
25 to be a reasonable addition to the reserve for losses

on qualifying real property loans, but such amount shall not exceed the amount determined under paragraph (2), (3), or (4), whichever amount is the largest.

“(2) 60 PERCENT OF TAXABLE INCOME METHOD.—The amount determined under this paragraph for the taxable year shall be the excess of—

“(A) an amount equal to 60 percent of the taxable income for such year, over

“(B) the amount referred to in paragraph (1) (A) for such year.

For purposes of this paragraph, taxable income shall be computed (i) by excluding from gross income any amount included therein by reason of subsection (f), and (ii) without regard to any deduction allowable for any addition to the reserve for bad debts.

“(3) 3 PERCENT OF REAL PROPERTY LOANS METHOD.—The amount determined under this paragraph for the taxable year shall be an amount equal to the amount necessary to increase the balance (as of the close of the taxable year) of the reserve for losses on qualifying real property loans to 3 percent of such loans outstanding at such time.

“(4) EXPERIENCE METHOD.—The amount determined under this paragraph for the taxable year shall

1 be an amount equal to the amount determined under
2 section 166 (c) (without regard to this subsection) to
3 be a reasonable addition to the reserve for losses on
4 qualifying real property loans.

5 “(c) TREATMENT OF RESERVES FOR BAD DEBTS.—

6 “(1) ESTABLISHMENT OF RESERVES.—Each tax-
7 payer described in subsection (a) which uses the reserve
8 method of accounting for bad debts shall establish and
9 maintain a reserve for losses on qualifying real property
10 loans, a reserve for losses on nonqualifying loans, and a
11 supplemental reserve for losses on loans. For purposes
12 of this title, such reserves shall be treated as reserves
13 for bad debts, but no deduction shall be allowed for any
14 addition to the supplemental reserve for losses on loans.

15 “(2) ALLOCATION OF PRE-1963 RESERVES.—For
16 purposes of this section, the pre-1963 reserves shall, as
17 of the close of December 31, 1962, be allocated to, and
18 constitute the opening balance of—

19 “(A) the reserve for losses on nonqualifying
20 loans,

21 “(B) the reserve for losses on qualifying real
22 property loans, and

23 “(C) the supplemental reserve for losses on
24 loans.

1 “(3) METHOD OF ALLOCATION.—The allocation
2 provided by paragraph (2) shall be made—

3 “(A) first, to the reserve described in para-
4 graph (2) (A), to the extent such reserve is not
5 increased above the amount which would be a
6 reasonable addition under section 166(c) for a
7 period in which the nonqualifying loans increased
8 from zero to the amount thereof outstanding at the
9 close of December 31, 1962;

10 “(B) second, to the reserve described in para-
11 graph (2) (B), to the extent such reserve is not
12 increased above the amount which would be deter-
13 mined under paragraph (3) or (4) of subsection
14 (b) (whichever such amount is the larger) for a
15 period in which the qualifying real property loans
16 increased from zero to the amount thereof outstand-
17 ing at the close of December 31, 1962; and

18 “(C) then to the supplemental reserve for
19 losses on loans.

20 “(4) PRE-1963 RESERVES DEFINED.—For purposes
21 of this subsection, the term ‘pre-1963 reserves’ means
22 the net amount, determined as of the close of December
23 31, 1962 (after applying subsection (d) (1)), accumu-
24 lated in the reserve for bad debts pursuant to section

1 166(c) (or the corresponding provisions of prior reve-
2 nue laws) for taxable years beginning after December
3 31, 1951.

4 “(5) CHARGING OF BAD DEBTS TO RESERVES.—

5 Any debt becoming worthless or partially worthless
6 in respect of a qualifying real property loan shall be
7 charged to the reserve for losses on such loans, and any
8 debt becoming worthless or partially worthless in re-
9 spect of a nonqualifying loan shall be charged to the
10 reserve for losses on nonqualifying loans; except that
11 any such debt may, at the election of the taxpayer, be
12 charged in whole or in part to the supplemental reserve
13 for losses on loans.

14 “(d) TAXABLE YEARS BEGINNING IN 1962 AND END-
15 ING IN 1963.—In the case of a taxable year beginning before
16 January 1, 1963, and ending after December 31, 1962, of
17 a taxpayer described in subsection (a) which uses the
18 reserve method of accounting for bad debts, the taxable in-
19 come shall be the sum of—

20 “(1) that portion of the taxable income allocable
21 to the part of the taxable year occurring before January
22 1, 1963, reduced by the amount of the deduction for an
23 addition to a reserve for bad debts which would be allow-
24 able under section 166(c) (without regard to the

amendments made by section 8 of the Revenue Act of 1962) if such part year constituted a taxable year, plus

“(2) that portion of the taxable income allocable to the part of the taxable year occurring after December 31, 1962, reduced by the amount of the deduction for an addition to a reserve for bad debts which would be allowed under section 166 (c) (taking into account the amendments made by section 8 of the Revenue Act of 1962) if such part year constituted a taxable year.

For purposes of the preceding sentence, the taxable income shall be determined without regard to any deduction under section 166 (c), and the portion thereof allocable to each part year shall be determined on the basis of the ratio which the number of days in such part year bears to the number of days in the entire taxable year.

“(e) LOANS DEFINED.—For purposes of this section—

“(1) QUALIFYING REAL PROPERTY LOANS.—The term ‘qualifying real property loan’ means any loan of the taxpayer secured by an interest in improved real property, but such term does not include—

“(A) any loan evidenced by a security (as defined in section 165 (g) (2) (C)) ;

“(B) any loan, whether or not evidenced by a

1 security (as defined in section 165'(g) (2) (C)),
2 the primary obligor on which is—

3 “(i) a government or political subdivision
4 or instrumentality thereof;

5 “(ii) a bank (as defined in section 581) ;
6 or

7 “(iii) another member of the same affil-
8 iated group;

9 “(C) any loan, to the extent secured by a
10 deposit in or share of the taxpayer; or

11 “(D) any loan which, within a 60-day period
12 beginning in one taxable year of the creditor and
13 ending in its next taxable year, is made or acquired
14 and then repaid or disposed of, unless the trans-
15 actions by which such loan was made or acquired
16 and then repaid or disposed of are established to be
17 for bona fide business purposes.

18 For purposes of subparagraph (B) (iii), the term
19 ‘affiliated group’ has the meaning assigned to such term
20 by section 1504 (a) ; except that (i) the phrase ‘more
21 than 50 percent’ shall be substituted for the phrase ‘at
22 least 80 percent’ each place it appears in section 1504
23 (a), and (ii) all corporations shall be treated as
24 includible corporations (without any exclusion under
25 section 1504 (b)).

1 “(2) NONQUALIFYING LOANS.—The term ‘non-
2 qualifying loan’ means any loan of the taxpayer which
3 is not a qualifying real property loan.

4 “(3) LOAN.—The term ‘loan’ means debt, as the
5 term ‘debt’ is used in section 166.

6 “(f) DISTRIBUTIONS TO SHAREHOLDERS.—

7 “(1) IN GENERAL.—For purposes of this chapter,
8 any distribution of property (as defined in section 317
9 (a)) by a domestic building and loan association to a
10 shareholder with respect to its stock, if such distribution
11 is not allowable as a deduction under section 591, shall
12 be treated as made—

13 “(A) first out of the reserve for losses on quali-
14 fying real property loans to the extent additions to
15 such reserve exceed the additions which would have
16 been allowed under subsection (b) (4) ,

17 “(B) then out of the supplemental reserve for
18 losses on loans, to the extent thereof,

19 “(C) then out of its earnings and profits ac-
20 cumulated in taxable years beginning after Decem-
21 ber 31, 1951, to the extent thereof, and

22 “(D) then out of such other accounts as may
23 be proper.

24 “(2) AMOUNTS CHARGED TO RESERVE ACCOUNTS
25 AND INCLUDED IN GROSS INCOME.—If any distribution

1 is treated under paragraph (1) as having been made
2 out of the reserves described in subparagraphs (A) and
3 (B) of such paragraph, the amount charged against
4 such reserve shall be the amount which, when reduced
5 by the amount of tax imposed under this chapter and
6 attributable to the inclusion of such amount in gross
7 income, is equal to the amount of such distribution; and
8 the amount so charged against such reserve shall be
9 included in gross income of the taxpayer.

10 “(3) SPECIAL RULES.—

11 “(A) For purposes of paragraph (1) (A),
12 additions to the reserve for losses on qualifying real
13 property loans for the taxable year in which the
14 distribution occurs shall be taken into account.

15 “(B) For purposes of computing under this
16 section the amount of a reasonable addition to the
17 reserve for losses on qualifying real property loans
18 for any taxable year, any amount charged during
19 any year to such reserve pursuant to the provisions
20 of paragraph (2) shall not be taken into account.

21 “(C) For purposes of this subsection, the term
22 ‘distribution’ includes any distribution in redemption
23 of stock or in partial or complete liquidation of the
24 association.”

25 (b) FORECLOSURE ON PROPERTY SECURING LOANS.—

1 Part II of subchapter H of chapter 1 (relating to mutual
2 savings banks, etc.) is amended by adding at the end thereof
3 the following new section:

4 **"SEC. 595. FORECLOSURE ON PROPERTY SECURING LOANS.**

5 " (a) NONRECOGNITION OF GAIN OR LOSS AS A RESULT
6 OF FORECLOSURE.—In the case of a creditor which is an
7 organization described in section 593 (a), no gain or loss
8 shall be recognized, and no debt shall be considered as be-
9 coming worthless or partially worthless, as the result of such
10 organization having bid in at foreclosure, or having otherwise
11 reduced to ownership or possession by agreement or process
12 of law, any property which was security for the payment of
13 any indebtedness.

14 " (b) CHARACTER OF PROPERTY.—For purposes of
15 sections 166 and 1221, any property acquired in a trans-
16 action with respect to which gain or loss to an organization
17 was not recognized by reason of subsection (a) shall be
18 considered as property having the same characteristics as
19 the indebtedness for which such property was security. Any
20 amount realized by such organization with respect to such
21 property shall be treated for purposes of this chapter as a
22 payment on account of such indebtedness, and any loss with
23 respect thereto shall be treated as a bad debt to which the
24 provisions of section 166 (relating to allowance of a deduc-
25 tion for bad debts) apply.

1 “(c) BASIS.—The basis of any property to which sub-
 2 section (a) applies shall be the basis of the indebtedness for
 3 which such property was security (determined as of the date
 4 of the acquisition of such property), properly increased for
 5 costs of acquisition.

6 “(d) REGULATORY AUTHORITY.—The Secretary or his
 7 delegate shall prescribe such regulations as he may deem
 8 necessary to carry out the purposes of this section.”

9 (c) DEFINITION OF DOMESTIC BUILDING AND LOAN
 10 ASSOCIATION.—Paragraph (19) of section 7701 (a) (def-
 11 inition of domestic building and loan association) is amended
 12 to read as follows:

13 “(19) DOMESTIC BUILDING AND LOAN ASSOCIA-
 14 TION.—The term ‘domestic building and loan association’
 15 means a domestic building and loan association, a do-
 16 mestic savings and loan association, and a Federal sav-
 17 ings and loan association, which—

18 “(A) is an insured institution (within the
 19 meaning of section 401 (a) of the National Housing
 20 Act (12 U.S.C., sec. 1724 (a)), or

21 “(B) is subject by law to supervision and
 22 examination by State or Federal authority having
 23 supervision over such associations,

24 if substantially all of its business consists of accepting
 25 savings and investing the proceeds (i) in loans secured

by an interest in real property which is (or, from the proceeds of the loan, will become) residential real property, and (ii) in other loans, to the extent such other loans would be authorized to be made by a Federal savings and loan association under the second paragraph of section 5 (c) of the Home Owners' Loan Act, as amended (12 U.S.C., sec. 1464 (c)).”

(d) CLERICAL AMENDMENTS.—The table of sections for part II of subchapter H of chapter 1 is amended—

(1) by striking out the third item and inserting in lieu thereof the following:

“Sec. 593. Reserves for losses on loans.”

and

(2) by adding at the end thereof the following:

“Sec. 595. Foreclosure on property securing loans.”

(e) REPEAL OF EXEMPTION FROM COMMUNICATIONS AND TRANSPORTATION OF PERSONS TAXES.—Notwithstanding any other provision of law, Federal savings and loan associations shall not be exempt as such from the taxes imposed by section 4251 (relating to excise tax on communications) and section 4261 (relating to excise tax on transportation of persons) of the Internal Revenue Code of 1954.

(f) EFFECTIVE DATES.—

(1) The amendment made by subsection (a) shall

1 apply to taxable years ending after December 31, 1962,
2 except that section 593 (f) of the Internal Revenue
3 Code of 1954 shall apply to distributions after Decem-
4 ber 31, 1962, in taxable years ending after such date.

5 (2) The amendment made by subsection (b) shall
6 apply to transactions described in section 595 (a) of the
7 Internal Revenue Code of 1954 occurring after Decem-
8 ber 31, 1962, in taxable years ending after such date.

9 (3) Subsection (e) of this section shall apply—

10 (A) in the case of the tax imposed by section
11 4251 of the Internal Revenue Code of 1954, with
12 respect to amounts paid pursuant to bills rendered
13 after June 30, 1962; and

14 (B) in the case of the tax imposed by section
15 4261 of such Code, with respect to transportation
16 beginning after June 30, 1962.

17 **SEC. 9. DISTRIBUTIONS BY FOREIGN TRUSTS.**

18 (a) DEFINITIONS.—

19 (1) INCOME OF FOREIGN TRUST.—Section 643 (a)
20 (6) (relating to modifications taken into account in com-
21 puting distributable net income) is amended to read as
22 follows:

23 “(6) INCOME OF FOREIGN TRUST.—In the case of
24 a foreign trust—

25 “(A) There shall be included the amounts of

gross income from sources without the United States, reduced by any amounts which would be deductible in respect of disbursements allocable to such income but for the provisions of section 265 (1) (relating to disallowance of certain deductions).

“(B) Gross income from sources within the United States shall be determined without regard to section 894 (relating to income exempt under treaty).

“(C) Subsection (a) (3) of this section shall not apply to a foreign trust created by a United States person. In the case of such a trust, (i) there shall be included gains from the sale or exchange of capital assets, reduced by losses from such sales or exchanges to the extent such losses do not exceed gains from such sales or exchanges, and (ii) the deduction under section 1202 (relating to deduction for excess of capital gains over capital losses) shall not be taken into account.”

(2) FOREIGN ESTATES AND TRUSTS.—Section 643 (relating to definitions) is amended by adding at the end thereof the following new subsection:

“(d) FOREIGN TRUSTS CREATED BY UNITED STATES PERSONS.—For purposes of this part, the term ‘foreign trust created by a United States person’ means a foreign trust (as

1 defined in section 7701 (a) (31)) to which money or prop-
 2 erty has been transferred directly or indirectly by a United
 3 States person (as defined in section 7701 (a) (30)), or under
 4 the will of a decedent who at the date of his death was a
 5 United States citizen or resident.”

6 (b) ACCUMULATION DISTRIBUTIONS OF FOREIGN
 7 TRUSTS.—

8 (1) Section 665 (b) (relating to definitions
 9 applicable to subpart D) is amended by striking out
 10 “(b) ACCUMULATION DISTRIBUTION.—For purposes
 11 of this subpart,” and inserting in lieu thereof the fol-
 12 lowing:

13 “(b) ACCUMULATION DISTRIBUTIONS OF TRUSTS
 14 OTHER THAN CERTAIN FOREIGN TRUSTS.—For purposes of
 15 this subpart, in the case of a trust (other than a foreign trust
 16 created by a United States person),”.

17 (2) Section 665 is amended by redesignating sub-
 18 sections (c) and (d) as (d) and (e), respectively,
 19 and by inserting after subsection (b) the following
 20 new subsection:

21 “(c) ACCUMULATION DISTRIBUTION OF CERTAIN
 22 FOREIGN TRUSTS.—For purposes of this subpart, in the case
 23 of a foreign trust created by a United States person, the term
 24 ‘accumulation distribution’ for any taxable year of the trust
 25 means the amount by which the amounts specified in para-

graph (2) of section 661 (a) for such taxable year exceed distributable net income, reduced by the amounts specified in paragraph (1) of section 661 (a). For purposes of this subsection, the amount specified in paragraph (2) of section 661 (a) shall be determined without regard to section 666. Any amount paid to a United States person which is from a payor who is not a United States person and which is derived directly or indirectly from a foreign trust created by a United States person shall be deemed in the year of payment to have been directly paid by the foreign trust."

(c) ALLOCATION OF ACCUMULATION DISTRIBUTIONS TO PRECEDING YEARS.—Section 666 (a) (relating to accumulation distribution allocated to 5 preceding years) is amended—

(1) by striking out "(a) AMOUNT ALLOCATED.—In the case of a trust" and inserting in lieu thereof the following:

"(a) AMOUNT ALLOCATED.—In the case of a trust (other than a foreign trust created by a United States person)"; and

(2) by adding at the end thereof the following new sentence:

"In the case of a foreign trust created by a United States person, this subsection shall apply to the preceding taxable years of the trust without regard to any provision of

1 the preceding sentences which would (but for this sentence)
2 limit its application to the 5 preceding taxable years.”

3 (d) AMOUNTS TREATED AS RECEIVED IN PRIOR
4 YEARS.—Section 668 (a) (relating to amounts treated as
5 received in prior taxable years) is amended by adding at
6 the end thereof the following new sentence: “Except as
7 provided in section 669, in the case of a foreign trust created
8 by a United States person the preceding sentence shall not
9 apply to any beneficiary who is a United States person.”

10 (e) SPECIAL RULES FOR FOREIGN TRUSTS.—Subpart
11 D of part I of subchapter J of chapter 1 (relating to treat-
12 ment of excess distributions by trusts) is amended by adding
13 at the end thereof the following new section:

14 **“SEC. 669. SPECIAL RULES APPLICABLE TO CERTAIN FOR-**
15 **EIGN TRUSTS.**

16 **“(a) LIMITATION ON TAX.—**

17 **“(1) GENERAL RULE.—**At the election of a bene-
18 ficiary who is a United States person (as defined in
19 section 7701 (a) (30)) and who satisfies the require-
20 ments of subsection (b), the tax attributable to the
21 amounts treated under section 668 (a) as having been
22 received by him from a foreign trust created by a United
23 States person on the last day of a preceding taxable
24 year of the trust shall not be greater than—

1 “(A) the tax determined under the next to the
2 last sentence of section 668 (a), or

3 “(B) the tax determined by multiplying by
4 the number of preceding taxable years of the trust,
5 on the last day of each of which an amount is
6 deemed under section 666 (a) to have been distrib-
7 uted, the average of the increase in tax attributable
8 to recomputing the beneficiary’s gross income for the
9 taxable year and each of his 2 taxable years imme-
10 diately preceding the year of the accumulation dis-
11 tribution by adding to the income of each of such
12 years an amount determined by dividing the amount
13 required to be included in income under section
14 668 (a) by such number of preceding taxable years
15 of the trust. The recomputation for the taxable year
16 shall be made without regard to the inclusion in
17 income required by section 668 (a) of any amount
18 other than pursuant to this paragraph.

19 “(2) EXCEPTIONS.—

20 “(A) When an accumulation distribution is
21 deemed under section 666 (a) to have been distrib-
22 uted on the last day of less than 3 taxable years
23 of the trust, the taxable years of the beneficiary for
24 which a recomputation is made under subsection

1 (a) (1) (B) shall equal the number of years to
2 which section 666 (a) applies, commencing with
3 the most recent taxable year of the beneficiary.

4 “(B) If a beneficiary was not alive on the last
5 day of each preceding taxable year of the trust
6 with respect to which a distribution is deemed made
7 under section 666 (a), paragraph (1) (A) of this
8 subsection shall not apply. In applying paragraph
9 (1) (B) of this subsection, no recomputation shall
10 be made for a beneficiary for a taxable year for
11 which he was not alive; if he has no preceding tax-
12 able year, the recomputation shall be made on the
13 basis of his taxable year without regard to the in-
14 clusion in income required by section 668 (a) of
15 any amount other than pursuant to paragraph
16 (1) (B).

17 “(3) EFFECT OF PRIOR ELECTION.—In comput-
18 ing the limitation on tax under paragraph (1) of this
19 subsection for any beneficiary—

20 “(A) SUBSEQUENT ELECTION UNDER PARA-
21 GRAPH (1)(A).—If an election has been made under
22 paragraph (1) (B) of this subsection, for purposes
23 of a subsequent election under paragraph (1) (A)
24 the income of any year with respect to which an

1 amount is deemed distributed to a beneficiary under
2 section 666 (a) shall include amounts previously
3 deemed distributed to such beneficiary for such
4 year as a result of an accumulation distribution with
5 respect to which an election under paragraph (1)
6 (B) was made.

7 “(B) SUBSEQUENT ELECTION UNDER PARA-
8 GRAPH (1)(B).—If with respect to an accumulation
9 distribution an election has been made under either
10 paragraph (1) (A) or paragraph (1) (B) of this
11 subsection, or the next to the last sentence of section
12 668 (a) has applied, for purposes of a subsequent
13 election under paragraph (1) (B) the number of
14 preceding taxable years of the trust with respect to
15 which an amount is deemed distributed to a benefi-
16 ciary under section 666 (a) shall be determined
17 without regard to any such year with respect to
18 which an amount was previously deemed distrib-
19 uted to such beneficiary.

20 “(b) INFORMATION REQUIREMENT.—The election of
21 a beneficiary to apply the limitations on tax provided in sub-
22 section (a) of this section shall not be effective unless the
23 beneficiary at the time of making the election supplies such
24 information with respect to the operation and accounts of the

1 trust, for each taxable year on the last day of which an
 2 amount is deemed distributed under section 666 (a), as the
 3 Secretary or his delegate may by regulations prescribe.”

4 (f) INFORMATION RETURNS WITH RESPECT TO FOR-
 5 EIGN TRUSTS.—Subpart B of part III of subchapter A of
 6 chapter 61 (relating to information concerning transactions
 7 with other persons) is amended by adding at the end thereof
 8 the following new section:

9 “SEC. 6047. RETURNS AS TO CREATION OF OR TRANSFERS
 10 TO CERTAIN FOREIGN TRUSTS.

11 “(a) GENERAL RULE.—On or before the 90th day
 12 after—

13 “(1) the creation of any foreign trust by a United
 14 States person, or

15 “(2) the transfer of any money or property to a
 16 foreign trust by a United States person,

17 the grantor in the case of an inter vivos trust, the fiduciary
 18 of an estate in the case of a testamentary trust, or the trans-
 19 feror, as the case may be, shall make a return in compliance
 20 with the provisions of subsection (b).

21 “(b) FORM AND CONTENTS OF RETURNS.—The re-
 22 turns required by subsection (a) shall be in such form and
 23 shall set forth, in respect of the foreign trust, such informa-
 24 tion as the Secretary or his delegate prescribes by regulation

1 as necessary for carrying out the provisions of the income
2 tax laws.

3 “(c) CROSS REFERENCES.—

“**(1) For provisions relating to penalties for violations
of this section, see sections 6677 and 7203.**

“**(2) For definition of the term ‘foreign trust created
by a United States person’, see section 643(d).”**

4 (g) FAILURE TO FILE INFORMATION RETURNS.—

5 Subchapter B of chapter 68 (relating to assessable penalties)
6 is amended by adding at the end thereof the following new
7 section:

8 **“SEC. 6677. FAILURE TO FILE INFORMATION RETURNS**
9 **WITH RESPECT TO CERTAIN FOREIGN**
10 **TRUSTS.**

11 “(a) CIVIL PENALTY.—In addition to any criminal
12 penalty provided by law, any person required to file a return
13 under section 6047 who fails to file such return at the time
14 provided in such section, or who files a return which does not
15 show the information required pursuant to such section, shall
16 pay a penalty equal to 5 percent of the amount transferred
17 to a trust, but not more than \$1,000, unless it is shown that
18 such failure is due to reasonable cause.

19 “(b) DEFICIENCY PROCEDURES NOT TO APPLY.—

20 Subchapter B of chapter 63 (relating to deficiency proce-
21 dures for income, estate, and gift taxes) shall not apply in

1 respect of the assessment or collection of any penalty
2 imposed by subsection (a).”

3 (h) UNITED STATES PERSON DEFINED.—Section
4 7701 (a) is amended by adding at the end thereof the
5 following new paragraphs:

6 “(30) UNITED STATES PERSON.—The term
7 ‘United States person’ means—

8 “(A) a citizen or resident of the United States,

9 “(B) a domestic partnership,

10 “(C) a domestic corporation, and

11 “(D) any estate or trust (other than a foreign
12 estate or foreign trust, within the meaning of sec-
13 tion 7701 (a) (31)).

14 “(31) FOREIGN ESTATE OR TRUST.—The terms
15 ‘foreign estate’ and ‘foreign trust’ mean an estate or
16 trust, as the case may be, the income of which from
17 sources without the United States is not includible in
18 gross income under subtitle A.”

19 (i) TECHNICAL AMENDMENTS.—

20 (1) The table of sections for subpart D of sub-
21 chapter J of chapter 1 (relating to treatment of excess

distributions by trusts) is amended by adding at the end thereof

“Sec. 669. Special rules applicable to certain foreign trusts.”

(2) The table of sections for subpart B of part III of subchapter A of chapter 61 (relating to information concerning transactions with other persons) is amended by adding at the end thereof

“Sec. 6047. Returns as to creation of or transfers to certain foreign trusts.”

(3) The table of sections for subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof

“Sec. 6677. Failure to file information returns with respect to certain foreign trusts.”

(j) **EFFECTIVE DATE.**—The amendments made by this section (other than by subsections (f), (g), and (h)) shall apply with respect to distributions made in taxable years of trusts beginning after the date of the enactment of this Act.

SEC. 10. MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE, MARINE, AND CERTAIN FIRE INSURANCE COMPANIES), ETC.

(a) **IMPOSITION OF TAX.**—So much of part II of subchapter L (relating to mutual insurance companies, other than life or marine or fire insurance companies issuing per-

petual policies) of chapter 1 as precedes section 822 is amended to read as follows:

**“PART II—MUTUAL INSURANCE COMPANIES
(OTHER THAN LIFE AND CERTAIN
MARINE INSURANCE COMPANIES
AND OTHER THAN FIRE INSURANCE
COMPANIES WHICH OPERATE ON
BASIS OF PERPETUAL POLICIES OR
PREMIUM DEPOSITS)**

“Sec. 821. Tax on mutual insurance companies to which part II applies.

“Sec. 822. Determination of taxable investment income.

“Sec. 823. Determination of statutory underwriting income or loss.

“Sec. 824. Adjustments to provide protection against losses.

“Sec. 825. Unused loss deduction.

“Sec. 826. Election by reciprocal.

“SEC. 821. TAX ON MUTUAL INSURANCE COMPANIES TO WHICH PART II APPLIES.

“(a) IMPOSITION OF TAX.—A tax is hereby imposed for each taxable year beginning after December 31, 1962, on the mutual insurance company taxable income of every mutual insurance company (other than a life insurance company and other than a fire or marine insurance company subject to the tax imposed by section 831). Such tax shall consist of—

“(1) NORMAL TAX.—A normal tax of 25 percent of the mutual insurance company taxable income, or

1 50 percent of the amount by which such taxable income
2 exceeds \$6,000, whichever is the lesser; plus

3 “(2) SURTAX.—A surtax of 22 percent of the
4 mutual insurance company taxable income (computed
5 without regard to the deduction provided in section 242
6 for partially tax-exempt interest) in excess of \$25,000.

7 “(b) MUTUAL INSURANCE COMPANY TAXABLE IN-
8 COME DEFINED.—For purposes of this part, the term ‘mutual
9 insurance company taxable income’ means, with respect to
10 any taxable year, the amount by which—

11 “(1) the sum of—

12 “(A) the taxable investment income (as de-
13 fined in section 822 (a) (1)),

14 “(B) the statutory underwriting income (as
15 defined in section 823 (a) (1)), and

16 “(C) the amounts required by section 824 (d)
17 to be subtracted from the protection against loss
18 account, exceeds

19 “(2) the sum of—

20 “(A) the investment loss (as defined in sec-
21 tion 822 (a) (2)),

22 “(B) the statutory underwriting loss (as de-
23 fined in section 823 (a) (2)), and

1 “(C) the unused loss deduction provided by
2 section 825 (a) .

3 “(c) ALTERNATIVE TAX FOR CERTAIN SMALL COM-
4 PANIES.—

5 “(1) IMPOSITION OF TAX.—In the case of taxable
6 years beginning after December 31, 1962, there is here-
7 by imposed for each taxable year on the income of each
8 mutual insurance company to which this subsection
9 applies a tax (which shall be in lieu of the tax imposed
10 by subsection (a)) computed as follows:

11 “(A) NORMAL TAX.—A normal tax of 25
12 percent of the taxable investment income, or 50
13 percent of the amount by which such taxable in-
14 come exceeds \$3,000, whichever is the lesser; plus

15 “(B) SURTAX.—A surtax of 22 percent of the
16 taxable investment income (computed without re-
17 gard to the deduction provided in section 242 for
18 partially tax-exempt interest) in excess of \$25,000.

19 “(2) GROSS AMOUNT RECEIVED, OVER \$75,000
20 BUT LESS THAN \$125,000.—If the gross amount re-
21 ceived during the taxable year from the items described
22 in section 822 (b) (other than paragraph (1) (D)
23 thereof) and premiums (including deposits and as-
24 sessments) is over \$75,000 but less than \$125,000, the
25 tax imposed by paragraph (1) shall be reduced to an

1 amount which bears the same proportion to the amount
2 of the tax determined under paragraph (1) as the
3 excess over \$75,000 of such gross amount received bears
4 to \$50,000.

5 “(3) COMPANIES TO WHICH SUBSECTION AP-
6 PLIES.—

7 “(A) IN GENERAL.—Except as provided in
8 subparagraph (B), this subsection shall apply to
9 every mutual insurance company (other than a life
10 insurance company and other than a fire or marine
11 insurance company subject to the tax imposed by
12 section 831) which received during the taxable year
13 from the items described in section 822 (b) (other
14 than paragraph (1) (D) thereof) and premiums
15 (including deposits and assessments) a gross
16 amount in excess of \$75,000 but not in excess of
17 \$300,000.

18 “(B) EXCEPTIONS.—This subsection shall not
19 apply to a mutual insurance company for the tax-
20 able year if—

21 “(i) there is in effect an election by such
22 company made under subsection (d) to be tax-
23 able under subsection (a) ; or

24 “(ii) there is any amount in the protection

1 against loss account at the beginning of the
2 taxable year.

3 “(d) ELECTION TO INCLUDE STATUTORY UNDER-
4 WRITING INCOME OR LOSS.—

5 “(1) IN GENERAL.—Any mutual insurance com-
6 pany which is subject to the tax imposed by subsection
7 (c) may elect, in such manner and at such time as the
8 Secretary or his delegate may by regulations prescribe,
9 to be subject to the tax imposed by subsection (a) .

10 “(2) EFFECT OF ELECTION.—If an election is made
11 under paragraph (1), the electing company shall be
12 subject to the tax imposed by subsection (a) (and shall
13 not be subject to the tax imposed by subsection (c))
14 for the first taxable year for which such election is made
15 and for all taxable years thereafter unless the Secretary
16 or his delegate consents to a revocation of such election.

17 “(e) NO UNITED STATES INSURANCE BUSINESS.—
18 Foreign mutual insurance companies (other than a life
19 insurance company and other than a fire or marine insurance
20 company subject to the tax imposed by section 831) not
21 carrying on an insurance business within the United States
22 shall not be subject to this part but shall be taxable as other
23 foreign corporations.

1 “(f) CROSS REFERENCES.—

 “(1) For exemption from tax of certain mutual insurance companies, see section 501(c)(15).

 “(2) For alternative tax in case of capital gains, see section 1201(a).”

2 (b) TAXABLE INVESTMENT INCOME.—

3 (1) IN GENERAL.—Section 822 (relating to de-
4 termination of mutual insurance company taxable
5 income) is amended by striking out the heading and sub-
6 section (a) and inserting in lieu thereof the following:

7 “SEC. 822. DETERMINATION OF TAXABLE INVESTMENT
8 INCOME.

9 “(a) DEFINITIONS.—For purposes of this part—

10 “(1) The term ‘taxable investment income’ means
11 the gross investment income, minus the deductions pro-
12 vided in subsection (c).

13 “(2) The term ‘investment loss’ means the amount
14 by which the deductions provided in subsection (c)
15 exceed the gross investment income.”

16 (2) CONFORMING AMENDMENTS.—Subsections (c)
17 and (e) of section 822 are each amended by striking
18 out “mutual insurance company taxable income” each
19 place it appears and inserting in lieu thereof “taxable
20 investment income”.

1 (3) DIVIDENDS RECEIVED DEDUCTION.—Section
 2 822 (c) (7) (relating to special deductions) is amended
 3 by adding at the end thereof the following new sentence:
 4 “In applying section 246 (b) (relating to limitation on
 5 aggregate amount of deductions for dividends received)
 6 for purposes of this paragraph, the reference in such
 7 section to ‘taxable income’ shall be treated as a reference
 8 to ‘taxable investment income’.”

9 (4) REDESIGNATION OF SECTION 823.—Part II of
 10 subchapter L of chapter 1 is amended by striking out
 11 “SEC. 823. OTHER DEFINITIONS.

12 “‘For purposes of this part—”,
 13 and inserting in lieu thereof (at the end of section 822)
 14 the following:

15 “(f) DEFINITIONS.—For purposes of this part—”.

16 (c) STATUTORY UNDERWRITING INCOME OR LOSS.—
 17 Part II of subchapter L of chapter 1 is amended by adding
 18 after section 822 (f) (as redesignated by subsection (b) (4)
 19 of this section) the following new sections:

20 “SEC. 823. DETERMINATION OF STATUTORY UNDERWRIT-
 21 ING INCOME OR LOSS.

22 “(a) IN GENERAL.—For purposes of this part—

23 “(1) The term ‘statutory underwriting income’
 24 means the amount by which—

25 “(A) the gross income which would be taken

1 into account in computing taxable income under
2 section 832 if the taxpayer were subject to the tax
3 imposed by section 831, reduced by the gross in-
4 vestment income, exceeds

5 “(B) the sum of (i) the deductions which
6 would be taken into account in computing taxable
7 income if the taxpayer were subject to the tax im-
8 posed by section 831, reduced by the deductions
9 provided in section 822 (c), plus (ii) the deductions
10 provided in subsection (c) and section 824 (a).

11 “(2) The term ‘statutory underwriting loss’ means
12 the excess of the amount referred to in paragraph
13 (1) (B) over the amount referred to in paragraph
14 (1) (A).

15 “(b) MODIFICATIONS.—In applying subsection (a)—

16 “(1) NET OPERATING LOSS DEDUCTION.—The de-
17 duction for net operating losses provided in section 172
18 shall not be allowed.

19 “(2) INTERINSURERS.—In the case of a mutual in-
20 surance company which is an interinsurer or reciprocal
21 underwriter—

22 “(A) there shall be allowed as a deduction the
23 increase for the taxable year in savings credited to
24 subscriber accounts, or

25 “(B) there shall be included as an item of

1 gross income the decrease for the taxable year in
2 savings credited to subscriber accounts.

3 For purposes of the preceding sentence, the term ‘sav-
4 ings credited to subscriber accounts’ means such portion
5 of the surplus as is credited to the individual accounts
6 of subscribers before the 16th day of the third month
7 following the close of the taxable year, but only if the
8 company would be obligated to pay such amount
9 promptly to such subscriber if he terminated his con-
10 tract at the close of the company’s taxable year. For
11 purposes of determining his taxable income, the sub-
12 scriber shall treat any such savings credited to his ac-
13 count as a dividend paid or declared.

14 “(c) SPECIAL DEDUCTION FOR SMALL COMPANY
15 HAVING GROSS AMOUNT OF LESS THAN \$900,000.—

16 “(1) IN GENERAL.—If the gross amount received
17 during the taxable year by a taxpayer subject to the tax
18 imposed by section 821 (a) from the items described
19 in section 822 (b) (other than paragraph (1) (D)
20 thereof) and premiums (including deposits and assess-
21 ments) does not equal or exceed \$900,000, then in
22 determining the statutory underwriting income or loss
23 for the taxable year there shall be allowed an additional
24 deduction of \$6,000; except that if such gross amount

1 exceeds \$300,000, such additional deduction shall be
2 equal to 1 percent of the amount by which \$900,000
3 exceeds such gross amount.

4 “(2) LIMITATION.—The amount of the deduction
5 allowed under paragraph (1) shall not exceed the
6 statutory underwriting income for the taxable year,
7 computed without regard to any deduction under this
8 subsection or section 824 (a).

9 **“SEC. 824. ADJUSTMENTS TO PROVIDE PROTECTION**
10 **AGAINST LOSSES.**

11 “(a) ALLOWANCE OF DEDUCTION.—

12 “(1) IN GENERAL.—In determining the statutory
13 underwriting income or loss for any taxable year there
14 shall be allowed as a deduction the sum of—

15 “(A) an amount equal to 1 percent of the losses
16 incurred during the taxable year (as determined
17 under section 832 (b) (5)), plus

18 “(B) an amount equal to 25 percent of the
19 underwriting gain for the taxable year, plus

20 “(C) if the concentrated windstorm, etc., pre-
21 mium percentage for the taxable year exceeds 50
22 percent, an amount determined by applying so much
23 of such percentage as exceeds 50 percent to the
24 underwriting gain for the taxable year.

1 For purposes of this paragraph, the term 'under-
 2 writing gain' means statutory underwriting income, com-
 3 puted without any deduction under this subsection.

4 “(2) SPECIAL RULE FOR COMPANIES HAVING CON-
 5 CENTRATED WINDSTORM, ETC., RISKS.—For purposes
 6 of paragraph (1) (C), the term 'concentrated wind-
 7 storm, etc., premium percentage' means, with respect to
 8 any taxable year, the percentage obtained by dividing—

9 “(A) the amount of the premiums earned
 10 on insurance contracts during the taxable year (as
 11 defined in section 832 (b) (4)), to the extent at-
 12 tributable to insuring against losses arising in any
 13 one State from windstorm, hail, flood, earthquake,
 14 or similar hazards, by

15 “(B) the amount of the premiums earned
 16 on insurance contracts during the taxable year (as
 17 so defined).

18 “(b) PROTECTION AGAINST LOSS ACCOUNT.—Each
 19 insurance company subject to the tax imposed by section
 20 821 (a) for any taxable year shall, for purposes of this part,
 21 establish and maintain a protection against loss account.

22 “(c) ADDITIONS TO ACCOUNT.—There shall be added
 23 to the protection against loss account for each taxable year
 24 an amount equal to the amount allowable as a deduction for
 25 the taxable year under subsection (a) (1).

1 “(d) SUBTRACTIONS.—

2 “(1) ANNUAL SUBTRACTIONS.—After applying
3 subsection (c), there shall be subtracted for the taxable
4 year from the protection against loss account—

5 “(A) first, an amount equal to the excess of
6 the statutory underwriting loss for the taxable year
7 over the underwriting loss (as defined in paragraph
8 (6)) for the taxable year,

9 “(B) then, the amount (if any) by which—

10 “(i) the sum of the investment loss for
11 such year and the underwriting loss for such
12 year, exceeds

13 “(ii) the sum of the statutory underwrit-
14 ing income for such taxable year and the taxable
15 investment income for such taxable year,

16 “(C) next (in the order in which the losses
17 occurred), amounts equal to the unused loss carry-
18 overs to such year,

19 “(D) next, any amount remaining which was
20 added to the account for the fifth preceding taxable
21 year, minus one-half of the amount remaining in the
22 account for such taxable year which was added
23 by reason of subsection (a) (1) (B), and

24 “(E) finally, the amount by which the total

1 amount in the account exceeds whichever of the
2 following is the greater:

3 “(i) 10 percent of premiums earned on in-
4 surance contracts during the taxable year (as
5 defined in section 832 (b) (4)) less dividends
6 to policyholders (as defined in section
7 832 (c) (11)), or

8 “(ii) the total amount in the account at
9 the close of the preceding taxable year.

10 “(2) RULES FOR CEILING ON PROTECTION AGAINST
11 LOSS ACCOUNT.—For purposes of paragraph (1) (E),
12 the total amount in the account shall be determined—

13 “(A) after the application of this section with-
14 out regard to paragraph (1) (E), and

15 “(B) without taking into consideration amounts
16 remaining in the account which were added, with re-
17 spect to all taxable years, by reason of subsection
18 (a) (1) (C) .

19 “(3) PRIORITIES.—The amounts required to be
20 subtracted from the protection against loss account—

21 “(A) under subparagraphs (A), (B), and
22 (C) of paragraph (1) shall be subtracted—

23 “(i) first (on a first-in, first-out, basis)
24 from amounts in the account with respect to

1 the five preceding taxable years and the taxable
2 year, and

3 “(ii) then from amounts in the account
4 with respect to earlier years,

5 “(B) under subparagraph (E) of paragraph
6 (1) shall be subtracted only from amounts in the
7 account with respect to the taxable year, and

8 “(C) under paragraphs (A), (B), (C), and
9 (E) of paragraph (1) shall, if the amount to be
10 subtracted from the total amounts in the account
11 with respect to any taxable year is less than such
12 total, be subtracted from each of the amounts (re-
13 ferred to in subsection (a) (1)) in the account with
14 respect to such year in the proportion which each
15 bears to such total.

16 “(4) TERMINATION OF TAXABILITY UNDER SEC-
17 TION 821.—If the taxpayer is not subject to tax under
18 section 821 for any taxable year, the entire amount in
19 the account at the close of the preceding taxable year
20 shall be subtracted from the account in such preceding
21 taxable year.

22 “(5) ELECTION TO SUBTRACT AMOUNT FROM
23 ACCOUNT.—

1 “(A) A taxpayer may elect for any taxable
2 year for which it is subject to tax under section
3 821 (a) to subtract from its protection against loss
4 account any amount which, but for the application of
5 this subparagraph, would be in such account as of
6 the close of such taxable year.

7 “(B) The election provided by subparagraph
8 (A) for any taxable year shall be made (in such
9 manner and in such form as the Secretary or his
10 delegate may by regulations prescribe) after the
11 close of such taxable year and not later than the time
12 prescribed by law for filing the return (including
13 extensions thereof) for the taxable year following
14 such taxable year. Such an election, once made,
15 may not be revoked.

16 “(6) UNDERWRITING LOSS DEFINED.—For pur-
17 poses of paragraph (1), the term ‘underwriting loss’
18 means the amount by which—

19 “(A) the deductions which would be taken
20 into account in computing taxable income under
21 section 832 if the taxpayer were subject to the tax
22 imposed by section 831, reduced by the sum of (i)
23 the deductions provided in section 822 (c), and (ii)
24 the deduction for dividends to policyholders pro-
25 vided by section 832 (c) (11), exceeds

1 “(B) the amount referred to in section 823

2 (a) (1) (A) .

3 **“SEC. 825. UNUSED LOSS DEDUCTION.**

4 “(a) **AMOUNT OF DEDUCTION.**—For purposes of this
5 part, the unused loss deduction for the taxable year shall be
6 an amount equal to the unused loss carryovers or carrybacks
7 to the taxable year.

8 “(b) **UNUSED LOSS DEFINED.**—For purposes of this
9 part, the term ‘unused loss’ means, with respect to any tax-
10 able year, the amount (if any) by which—

11 “(1) the sum of the statutory underwriting loss
12 and the investment loss, exceeds

13 “(2) the sum of—

14 “(A) the taxable investment income,

15 “(B) the statutory underwriting income, and

16 “(C) the amounts required by section 824 (d)
17 to be subtracted from the protection against loss
18 account.

19 “(c) **LOSS YEAR DEFINED.**—For purposes of this part,
20 the term ‘loss year’ means, with respect to any company
21 subject to the tax imposed by section 821 (a), any tax-
22 able year in which the unused loss (as defined in subsection
23 (b)) of such taxpayer is more than zero.

24 “(d) **YEARS TO WHICH CARRIED.**—The unused loss
25 for any loss year shall be—

1 “(1) an unused loss carryback to each of the 3
2 taxable years preceding the loss year, and

3 “(2) an unused loss carryover to each of the 5
4 taxable years following the loss year.

5 “(e) AMOUNT OF CARRYBACKS AND CARRYOVERS.—

6 The entire amount of the unused loss for any loss year shall
7 be carried to the earliest of the taxable years to which such
8 loss may be carried. The portion of such loss which shall
9 be carried to each of the other taxable years shall be the
10 excess (if any) of the amount of such loss over the sum
11 of the offsets (as defined in subsection (f)) for each of the
12 prior taxable years to which such loss may be carried.

13 “(f) OFFSET DEFINED.—For purposes of subsection
14 (e) , the term ‘offset’ means with respect to any taxable year
15 (hereinafter referred to as the ‘offset year’) —

16 “(1) in the case of an unused loss carryback from
17 the loss year to the offset year, the mutual insurance
18 company taxable income for the offset year; or

19 “(2) in the case of an unused loss carryover from
20 the loss year to the offset year, an amount equal to the
21 sum of—

22 “(A) the amount required to be subtracted
23 from the protection against loss account under sec-
24 tion 824 (d) (1) (C) for the offset year, plus

1 “(B) the mutual insurance company taxable
2 income for the offset year.

3 For purposes of paragraphs (1) and (2) (B), the mutual
4 insurance taxable income for the offset year shall be deter-
5 mined without regard to any unused loss carryback or carry-
6 over from the loss year or any taxable year thereafter.

7 “(g) LIMITATIONS.—For purposes of this part, an un-
8 used loss shall not be carried—

9 “(1) to or from any taxable year beginning before
10 January 1, 1963,

11 “(2) to or from any taxable year for which the
12 insurance company is not subject to the tax imposed by
13 section 821 (a), nor

14 “(3) to any taxable year if, between the loss year
15 and such taxable year, there is an intervening taxable
16 year for which the insurance company was not subject
17 to the tax imposed by section 821 (a).

18 **“SEC. 826. ELECTION BY RECIPROCAL.**

19 “(a) IN GENERAL.—Except as otherwise provided in
20 this section, any mutual insurance company which is an
21 interinsurer or reciprocal underwriter (hereinafter in this
22 section referred to as a ‘reciprocal’) subject to the taxes im-
23 posed by section 821 (a) may, under regulations prescribed
24 by the Secretary or his delegate, elect to be subject to the

1 limitation provided in subsection (b). Such election shall
2 be effective for the taxable year for which made and for all
3 succeeding taxable years, and shall not be revoked except
4 with the consent of the Secretary or his delegate.

5 “(b) LIMITATION.—The deduction for amounts paid or
6 incurred in the taxable year to the attorney-in-fact by a
7 reciprocal making the election provided in subsection (a)
8 shall be limited to, but in no case increased by, the deductions
9 of the attorney-in-fact allocable, in accordance with regula-
10 tions prescribed by the Secretary or his delegate, to the
11 income received by the attorney-in-fact from the reciprocal.

12 “(c) EXCEPTION.—An election may not be made by a
13 reciprocal under subsection (a) unless the attorney-in-fact
14 of such reciprocal—

15 “(1) is subject to the taxes imposed by section 11
16 (b) and (c) ;

17 “(2) consents in such manner as the Secretary or
18 his delegate shall prescribe by regulations to make
19 available such information as may be required during the
20 period in which the election provided in subsection (a)
21 is in effect, under regulations prescribed by the Secretary
22 or his delegate ;

23 “(3) reports the income received from the recipro-

cal and the deductions allocable thereto under the same method of accounting under which the reciprocal reports deductions for amounts paid to the attorney-in-fact; and

“(4) files its return on the calendar year basis.

“(d) SPECIAL RULE.—For purposes of computing the deduction provided in section 824 (a) and the additions to the account provided by section 824 (c) with respect to any reciprocal electing to be subject to the limitation provided in subsection (b), such limitation shall not be taken into account.

“(e) CREDIT.—Any reciprocal electing to be subject to the limitation provided in subsection (b) shall be credited with so much of the tax paid by the attorney-in-fact as is attributable, under regulations prescribed by the Secretary or his delegate, to the income received by the attorney-in-fact from the reciprocal in such taxable year.

“(f) SURTAX EXEMPTION DENIED.—Any increase in taxable income of a reciprocal attributable to the limitation provided in subsection (b) shall be taxed without regard to the surtax exemption provided in section 821 (a) (2).

“(g) ADJUSTMENT FOR REFUND.—If for any taxable year an attorney-in-fact is allowed a credit or refund for taxes paid with respect to which a reciprocal was allowed

1 a credit under subsection (e), the taxes of such reciprocal
 2 for such taxable year shall be properly adjusted under regu-
 3 lations prescribed by the Secretary or his delegate.

4 “(h) TAXES OF ATTORNEY-IN-FACT UNAFFECTED.—
 5 Nothing in this section shall increase or decrease the taxes
 6 imposed by this chapter on the income of the attorney-in-
 7 fact.”

8 (d) MUTUAL FIRE INSURANCE COMPANIES OPERAT-
 9 ING ON BASIS OF PREMIUM DEPOSITS.—

10 (1) APPLICATION OF SECTION 831(a).—Section
 11 831 (a) (imposing a tax on certain mutual marine and
 12 fire insurance companies and on stock insurance com-
 13 panies which are not life insurance companies) is
 14 amended to read as follows:

15 “(a) IMPOSITION OF TAX.—Taxes computed as pro-
 16 vided in section 11 shall be imposed for each taxable year or
 17 the taxable income of—

18 “(1) every insurance company (other than a life
 19 or mutual insurance company),

20 “(2) every mutual marine insurance company, and

21 “(3) every mutual fire insurance company—

22 “(A) exclusively issuing perpetual policies, or

23 “(B) whose principal business is the issuance
 24 of policies for which the premium deposits are the
 25 same, regardless of the length of the term for which

1 the policies are written, if the unabsorbed portion
2 of such premium deposits not required for losses,
3 expenses, or establishment of reserves is returned or
4 credited to the policyholder on cancellation or ex-
5 piration of the policy.”

6 (2) TREATMENT OF UNABSORBED PREMIUM DE-
7 POSITS.—Section 832 (b) (4) (relating to definition of
8 premiums earned) is amended by adding at the end
9 thereof the following new sentence: “For purposes of
10 this subsection, unearned premiums of mutual fire in-
11 surance companies described in section 831 (a) (3) (B)
12 means (with respect to the policies described in section
13 831 (a) (3) (B) the amount of unabsorbed premium
14 deposits which the company would be obligated to re-
15 turn to its policyholders at the close of the taxable year
16 if all of its policies were terminated at such time; and
17 the determination of such amount shall be based on the
18 schedule of unabsorbed premium deposit returns for each
19 such company then in effect.”

20 (3) CONFORMING AMENDMENT.—Section 832 (b)
21 (1) (C) is amended by striking out “section 831 (a),”
22 and inserting in lieu thereof “section 831 (a) (3) (A),”.

23 (4) ADJUSTMENT OF PREMIUM DEPOSIT.—Section
24 832 (c) (11) is amended to read as follows:

25 “(11) dividends and similar distributions paid or

1 declared to policyholders in their capacity as such, ex-
 2 cept in the case of a mutual fire insurance company de-
 3 scribed in section 831 (a) (3) (A). For purposes of
 4 the preceding sentence, the term 'dividends and similar
 5 distributions' includes amounts returned or credited to
 6 policyholders on cancellation or expiration of policies
 7 described in section 831 (a) (3) (B). For purposes of
 8 this paragraph, the term 'paid or declared' shall be con-
 9 strued according to the method of accounting regularly
 10 employed in keeping the books of the insurance com-
 11 pany; and".

12 (5) ADDITIONAL ITEM OF INCOME.—Section
 13 832 (b) (1) is amended by striking out "and" at the end
 14 of subparagraph (B), by striking out the period at the
 15 end of subparagraph (C) and inserting in lieu thereof
 16 ", and", and by adding at the end thereof the following
 17 new subparagraph:

18 "(D) in the case of a mutual fire insurance
 19 company described in section 831 (a) (3) (B), an
 20 amount equal to 2 percent of the premiums earned
 21 on insurance contracts during the taxable year with
 22 respect to policies described in section 831 (a) (3)
 23 (B) after deduction of premium deposits returned
 24 or credited during the same taxable year."

25 (e) ELECTION OF CERTAIN MUTUAL COMPANIES TO

1 BE TAXED ON TOTAL INCOME.—Section 831 is amended
2 by redesignating subsection (c) as subsection (d), and by
3 inserting after subsection (b) the following new subsection:

4 “(c) ELECTION FOR MULTIPLE LINE COMPANY TO BE
5 TAXED ON TOTAL INCOME.—

6 “(1) IN GENERAL.—Any mutual insurance com-
7 pany engaged in writing marine, fire, and casualty insur-
8 ance which for any 5-year period beginning after
9 December 31, 1941, and ending before January 1, 1962,
10 was subject to the tax imposed by section 831 (or the
11 tax imposed by corresponding provisions of prior law)
12 may elect, in such manner and at such time as the
13 Secretary or his delegate may by regulations prescribe,
14 to be subject to the tax imposed by section 831, whether
15 or not marine insurance is its predominant source of
16 premium income.

17 “(2) EFFECT OF ELECTION.—If an election is
18 made under paragraph (1), the electing company shall
19 (in lieu of being subject to the tax imposed by section
20 821) be subject to the tax imposed by this section for
21 taxable years beginning after December 31, 1961.
22 Such election shall not be revoked except with the con-
23 sent of the Secretary or his delegate.”

24 (f) TECHNICAL AMENDMENTS, ETC.—

25 (1) CREDIT FOR FOREIGN TAXES.—Section 841

1 (relating to credit for foreign taxes) is amended
2 by striking out “and” at the end of paragraph (1), by
3 renumbering paragraph (2) as paragraph (3), and by
4 inserting after paragraph (1) the following new para-
5 graph:

6 “(2) in the case of the tax imposed by section
7 821 (a), the mutual insurance company taxable income
8 (as defined in section 821 (b)) ; and in the case of the
9 tax imposed by section 821 (c) , the taxable investment
10 income (as defined in section 822 (a)) , and”.

11 (2) ADJUSTMENTS TO BASIS FOR DEPRECIATION
12 SUSTAINED.—Section 1016 (a) (3) (relating to adjust-
13 ments to basis for depreciation, etc., sustained) is
14 amended by striking out “and” at the end of subpara-
15 graph (B), by inserting “and” at the end of sub-
16 paragraph (C), and by inserting after subparagraph
17 (C) the following new subparagraph:

18 “(D) since February 28, 1913, during which
19 such property was held by a person subject to tax
20 under part II of subchapter L (or the corresponding
21 provisions of prior income tax laws), to the extent
22 that paragraph (2) does not apply,”.

23 (3) ALTERNATIVE TAX ON CAPITAL GAINS.—
24 Section 1201 (a) (relating to alternative tax on corpo-

1 rations) is amended by striking out "821 (a) (1) or
2 (b)," and inserting in lieu thereof "821 (a) or (c),".

3 (4) CLERICAL AMENDMENT.—The table of parts
4 for subchapter L is amended by striking out the portion
5 referring to part II and inserting in lieu thereof the
6 following:

"Part II. Mutual insurance companies (other than life and
certain marine insurance companies and other
than fire insurance companies which operate on
basis of perpetual policies or premium de-
posits)."

7 (g) EFFECTIVE DATE.—The amendments made by this
8 section (other than by subsection (e)) shall apply with re-
9 spect to taxable years beginning after December 31, 1962.

10 **SEC. 11. DOMESTIC CORPORATIONS RECEIVING DIVI-**
11 **DENDS FROM FOREIGN CORPORATIONS.**

12 (a) ENTIRE AMOUNT OF FOREIGN TAX TO BE TAKEN
13 INTO ACCOUNT.—

14 (1) DEFINITION OF ACCUMULATED PROFITS.—So
15 much of paragraph (1) of section 902 (c) (relating to
16 applicable rules for computing credit for corporate stock-
17 holder in foreign corporation) as precedes the semicolon
18 is amended to read as follows:

19 " (1) The term 'accumulated profits', when used in
20 this section in reference to a foreign corporation, means
21 the amount of its gains, profits, or income computed

1 without reduction by the amount of the income, war
2 profits, and excess profits taxes imposed on or with re-
3 spect to such profits or income by any foreign country
4 or any possession of the United States”.

5 (2) CONFORMING AMENDMENTS.—

6 (A) Section 902 (a) is amended by striking
7 out “which the amount of such dividends bears to
8 the amount of such accumulated profits” and insert-
9 ing in lieu thereof “which the amount of such
10 dividends (determined without regard to section
11 78) bears to the amount of such accumulated profits
12 in excess of such income, war profits, and excess
13 profits taxes (other than those deemed paid)”.

14 (B) Section 902 (b) is amended by striking
15 out “which the amount of such dividends bears to
16 the amount of such accumulated profits” and in-
17 serting in lieu thereof “which the amount of such
18 dividends bears to the amount of such accumulated
19 profits in excess of such income, war profits, and
20 excess profits taxes”.

21 (b) INCLUSION IN GROSS INCOME OF AMOUNT
22 EQUAL TO TAXES DEEMED PAID.—Part II of subchapter B
23 of chapter 1 (relating to items specifically included in gross
24 income) is amended by adding at the end thereof the fol-
25 lowing new section:

1 **“SEC. 78. DIVIDENDS RECEIVED FROM FOREIGN CORPO-**
2 **RATIONS BY DOMESTIC CORPORATIONS CHOOS-**
3 **ING FOREIGN TAX CREDIT.**

4 “If a domestic corporation chooses to have the benefits
5 of subpart A of part III of subchapter N (relating to foreign
6 tax credit) for any taxable year, an amount equal to the
7 taxes deemed to be paid by such corporation under section
8 902 (relating to credit for corporate stockholder in foreign
9 corporation) or under section 957 (a) (relating to taxes
10 paid by foreign corporation) for such taxable year shall be
11 treated for purposes of this title (other than section 245) as
12 a dividend received by such domestic corporation from the
13 foreign corporation.”

14 (c) DETERMINATION OF SOURCE OF DIVIDENDS RE-
15 CEIVED FROM CERTAIN FOREIGN CORPORATIONS.—Section
16 861 (a) (2) (B) (relating to dividends from foreign cor-
17 porations treated as income from sources within the United
18 States) is amended by striking out “to the extent exceeding
19 the amount of the deduction allowable under section 245 in
20 respect of such dividends” and inserting in lieu thereof “to
21 the extent exceeding the amount which is 100/85ths of the
22 amount of the deduction allowable under section 245 in
23 respect of such dividends”.

24 (d) REPEAL OF SECTION 902 (d).—Subsection (d)

1 (relating to special rules for certain wholly owned foreign
2 corporations) is hereby repealed.

3 (e) TECHNICAL AMENDMENTS.—

4 (1) The table of sections for part II of subchapter
5 B of chapter 1 is amended by adding at the end thereof
6 the following:

“Sec. 78. Dividends received from foreign corporations by
domestic corporations choosing foreign tax
credit.”

7 (2) Section 535 (b) (1) and the first sentence of
8 section 545 (b) (1) are each amended by striking out
9 “accrued during the taxable year,” and inserting in lieu
10 thereof “accrued during the taxable year or deemed to
11 be paid by a domestic corporation under section 902 for
12 the taxable year,”.

13 (3) Section 901 (d) is amended by adding the
14 following new paragraph:

“(4) For reduction of credit for failure of a United
States person to furnish certain information with respect
to a foreign corporation controlled by him, see section
6038.”

15 (4) Section 902 is amended by striking out subsec-
16 tion (e) and inserting in lieu thereof the following:

17 “(d) CROSS REFERENCES.—

“(1) For inclusion in gross income of an amount equal
to taxes deemed paid under this section, see section 78.

“(2) For reduction of credit with respect to dividends
paid out of accumulated profits for years for which cer-
tain information is not furnished, see section 6038.”

1 (f) EFFECTIVE DATE.—The amendments made by this
2 section shall apply—

3 (1) in respect of any distribution received by a
4 domestic corporation after December 31, 1964, and

5 (2) in respect of any distribution received by a
6 domestic corporation before January 1, 1965, in a tax-
7 able year of such corporation beginning after December
8 31, 1962, but only to the extent that such distribution
9 is made out of the accumulated profits of a foreign
10 corporation for a taxable year (of such foreign corpora-
11 tion) beginning after December 31, 1962.

12 For purposes of paragraph (2), a distribution made by a
13 foreign corporation out of its profits which are attributable
14 to a distribution received from a foreign subsidiary to which
15 section 902 (b) applies shall be treated as made out of the
16 accumulated profits of a foreign corporation for a taxable
17 year beginning before January 1, 1963, to the extent that
18 such distribution was paid out of the accumulated profits of
19 such foreign subsidiary for a taxable year beginning before
20 January 1, 1963.

1 SEC. 12. EARNED INCOME FROM SOURCES WITHOUT THE
2 UNITED STATES.

3 (a) LIMITATION ON AMOUNT AND TYPE OF INCOME
4 EXCLUDED.—Section 911 (relating to earned income from
5 sources without the United States) is amended to read as
6 follows:

7 “SEC. 911. EARNED INCOME FROM SOURCES WITHOUT
8 THE UNITED STATES.

9 “(a) GENERAL RULE.—The following items shall not
10 be included in gross income and shall be exempt from tax-
11 ation under this subtitle:

12 “(1) BONA FIDE RESIDENT OF FOREIGN COUN-
13 TRY.—In the case of an individual citizen of the United
14 States who establishes to the satisfaction of the Secre-
15 tary or his delegate that he has been a bona fide resident
16 of a foreign country or countries for an uninterrupted
17 period which includes an entire taxable year, amounts
18 received from sources without the United States (except
19 amounts paid by the United States or any agency there-
20 of) which constitute earned income attributable to serv-
21 ices performed during such uninterrupted period. The
22 amount excluded under this paragraph for any taxable
23 year shall be computed by applying the special rules
24 contained in subsection (c).

25 “(2) PRESENCE IN FOREIGN COUNTRY FOR 17

1 MONTHS.—In the case of an individual citizen of the
2 United States who during any period of 18 consecutive
3 months is present in a foreign country or countries dur-
4 ing at least 510 full days in such period, amounts re-
5 ceived from sources without the United States (except
6 amounts paid by the United States or any agency
7 thereof) which constitute earned income attributable to
8 services performed during such 18-month period. The
9 amount excluded under this paragraph for any taxable
10 year shall be computed by applying the special rules
11 contained in subsection (c).

12 An individual shall not be allowed, as a deduction from his
13 gross income, any deductions (other than those allowed by
14 section 151, relating to personal exemptions) properly allo-
15 cable to or chargeable against amounts excluded from gross
16 income under this subsection.

17 “(b) DEFINITION OF EARNED INCOME.—For purposes
18 of this section, the term ‘earned income’ means wages, sal-
19 aries, or professional fees, and other amounts received as
20 compensation for personal services actually rendered, but
21 does not include that part of the compensation derived by
22 the taxpayer for personal services rendered by him to a
23 corporation which represents a distribution of earnings or
24 profits rather than a reasonable allowance as compensation
25 for the personal services actually rendered. In the case of

1 a taxpayer engaged in a trade or business in which both
2 personal services and capital are material income-producing
3 factors, under regulations prescribed by the Secretary or his
4 delegate, a reasonable allowance as compensation for the
5 personal services rendered by the taxpayer, not in excess of
6 30 percent of his share of the net profits of such trade or
7 business, shall be considered as earned income.

8 “(c) SPECIAL RULES.—For purposes of computing the
9 amount excludable under subsection (a), the following rules
10 shall apply:

11 “(1) LIMITATIONS ON AMOUNT OF EXCLUSION.—
12 The amount excluded from the gross income of an
13 individual under subsection (a) for any taxable year
14 shall not exceed an amount which shall be computed on
15 a daily basis at an annual rate of—

16 “(A) except as provided in subparagraph (B),
17 \$20,000 in the case of an individual who qualifies
18 under subsection (a), or

19 “(B) \$35,000 in the case of an individual who
20 qualifies under subsection (a) (1), but only with
21 respect to that portion of such taxable year occurring
22 after such individual has been a bona fide resident
23 of a foreign country or countries for an uninterrupted
24 period of 3 consecutive years.

25 “(2) ATTRIBUTION TO YEAR IN WHICH SERVICES

1 ARE PERFORMED.—For purposes of applying paragraph
2 (1), amounts received shall be considered received in
3 the taxable year in which the services to which the
4 amounts are attributable are performed.

5 “(3) TREATMENT OF COMMUNITY INCOME.—In
6 applying paragraph (1) with respect to amounts re-
7 ceived for services performed by a husband or wife
8 which are community income under community prop-
9 erty laws applicable to such income, the aggregate
10 amount excludable under subsection (a) from the gross
11 income of such husband and wife shall equal the amount
12 which would be excludable if such amounts did not con-
13 stitute such community income.

14 “(4) REQUIREMENT AS TO TIME OF RECEIPT.—
15 No amount received after the close of the taxable year
16 following the taxable year in which the services to which
17 the amounts are attributable are performed may be ex-
18 cluded under subsection (a).

19 “(5) CERTAIN AMOUNTS NOT EXCLUDABLE.—No
20 amount—

21 “(A) received as a pension or annuity, or

22 “(B) included in gross income by reason of
23 section 402(b) (relating to taxability of benefi-
24 ciary of non-exempt trust), section 403(c) (relat-
25 ing to taxability of beneficiary under a non-quali-

1 fied annuity), or section 403 (d) (relating to
2 taxability of beneficiary under certain forfeitable
3 contracts purchased by exempt organizations),
4 may be excluded under subsection (a).

5 “(d) CROSS REFERENCES.—

 “**For administrative and penal provisions relating to
the exclusion provided for in this section, see sections
6001, 6011, 6012(c), and the other provisions of subtitle F.**”

6 (b) COMPUTATION OF EMPLOYEES’ CONTRIBU-
7 TIONS.—Section 72 (f) (relating to special rules for comput-
8 ing employees’ contributions) is amended by adding after
9 paragraph (2) the following new sentences:
10 “Paragraph (2) shall not apply to amounts which were con-
11 tributed by the employer after December 31, 1962, and
12 which would not have been includible in the gross income of
13 the employee by reason of the application of section 911 if
14 such amounts had been paid directly to the employee at the
15 time of contribution. The preceding sentence shall not apply
16 to amounts which were contributed by the employer, as de-
17 termined under regulations prescribed by the Secretary or his
18 delegate, to provide pension or annuity credits, to the extent
19 such credits are attributable to services performed before
20 January 1, 1963, and are provided pursuant to pension or
21 annuity plan provisions in existence on March 12, 1962,
22 and on that date applicable to such services.”

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years ending after December 31, 1962.

(2) AMENDMENTS TO SECTION 911.—The amendment made by subsection (a) shall apply only with respect to amounts received after December 31, 1962, and which are attributable either to—

(A) services performed after such date, or

(B) services performed on or before such date, but only if on March 12, 1962, there existed no right (whether forfeitable or nonforfeitable) to receive such amounts.

SEC. 13. CONTROLLED FOREIGN CORPORATIONS.

(a) IN GENERAL.—Part III of subchapter N of chapter 1 (relating to income from sources without the United States) is amended by adding at the end thereof the following new subpart:

“Subpart F—Controlled Foreign Corporations

“Sec. 951. Amounts included in gross income of United States persons.

“Sec. 952. Subpart F income defined.

“Sec. 953. Investment of earnings in nonqualified property.

“Sec. 954. Controlled foreign corporations.

“Sec. 955. Rules for determining stock ownership.

“Sec. 956. Exclusion from gross income of previously taxed earnings and profits.

“Sec. 957. Special rules for foreign tax credit.

“Sec. 958. Adjustments to basis of stock in controlled foreign corporations and of other property.

1 “SEC. 951. AMOUNTS INCLUDED IN GROSS INCOME OF
2 UNITED STATES PERSONS.

3 “(a) AMOUNTS INCLUDED.—

4 “(1) IN GENERAL.—If a foreign corporation is a
5 controlled corporation on any day of a taxable year be-
6 ginning after December 31, 1962, every United States
7 person (as defined in section 7701 (a) (30)) who owns
8 (within the meaning of section 955 (a)) stock in such
9 corporation on the last day, in such year, on which such
10 corporation is a controlled foreign corporation shall in-
11 clude in his gross income, for his taxable year in which
12 or with which such taxable year of the corporation
13 ends—

14 “(A) his pro rata share (determined under
15 paragraph (2)) of the corporation’s subpart F
16 income for such year, and

17 “(B) his pro rata share (determined under
18 section 953 (a) (2)) of the corporation’s increase
19 in earnings invested in nonqualified property for
20 such year (but only to the extent not excluded
21 from gross income under section 956 (a) (2)).

22 “(2) PRO RATA SHARE OF SUBPART F INCOME.—

23 The pro rata share referred to in paragraph (1) (A)
24 in the case of any United States person is the amount—

25 “(A) which would have been distributed with

1 respect to the stock which such person owns (with-
2 in the meaning of section 955 (a)) in such cor-
3 poration if on the last day, in its taxable year, on
4 which the corporation is a controlled foreign cor-
5 poration it had distributed pro rata to its share-
6 holders an amount (i) which bears the same ratio
7 to its subpart F income for the taxable year, as
8 (ii) the part of such year during which the corpora-
9 tion is a controlled foreign corporation bears to the
10 entire year, reduced by

11 “(B) the amount of any distribution received
12 by any other United States person during such
13 year as a dividend with respect to such stock.

14 “(3) LIMITATION ON AMOUNT OF PRO RATA
15 SHARE OF INVESTMENT IN NONQUALIFIED PROPERTY
16 INCLUDED IN GROSS INCOME.—For purposes of para-
17 graph (1) (B) , the pro rata share of any United States
18 person in the increase of the earnings of a controlled
19 foreign corporation invested in nonqualified property
20 shall not exceed an amount (A) which bears the same
21 ratio to his pro rata share of such increase (as deter-
22 mined under section 953 (a) (2)) for the taxable
23 year, as (B) the part of such year during which the
24 corporation is a controlled foreign corporation bears to
25 the entire year.

1 “(b) LESS THAN 10-PERCENT OWNERSHIP.—No per-
 2 son shall be required to include any amount in gross income
 3 under subsection (a) unless he can be considered, by apply-
 4 ing the rules of ownership of section 955 (b), as owning,
 5 directly or indirectly, on any day during the taxable year
 6 of the corporation on which it was a controlled foreign cor-
 7 poration, 10 percent or more of the total combined voting
 8 power of all classes of stock, or of the total value of shares
 9 of all classes of stock, of such corporation.

10 “(c) COORDINATION WITH ELECTION OF A FOREIGN
 11 INVESTMENT COMPANY TO DISTRIBUTE INCOME.—A
 12 United States person who, for his taxable year, is a qualified
 13 shareholder (within the meaning of section 1247 (c)) of a
 14 foreign investment company with respect to which an elec-
 15 tion under section 1247 is in effect shall not be required to
 16 include in gross income, for such taxable year, subpart F
 17 income of such company.

18 “SEC. 952. SUBPART F INCOME DEFINED.

19 “(a) IN GENERAL.—

20 “(1) ITEMS TAKEN INTO ACCOUNT.—For purposes
 21 of this subpart, the term ‘subpart F income’ means, in
 22 the case of any controlled foreign corporation, the sum
 23 of—

24 “(A) income derived from insurance of United
 25 States risks (as determined under subsection (b)),

“ (B) income from United States patents,
copyrights, and exclusive formulas and processes
(as determined under subsection (c)), and

“ (C) the net foreign base company income
(as determined under subsection (d)), except that
this subparagraph shall apply only in the case of a
controlled foreign corporation in which 5 or fewer
United States persons own, by applying the rules of
ownership of section 955 (b) , more than 50 percent
of the total combined voting power of all classes of
stock entitled to vote.

“(2) EXCLUSION OF UNITED STATES INCOME.—
Subpart F income does not include any item includible
in gross income under this chapter (other than this sub-
part) as income derived from sources within the United
States of a foreign corporation engaged in trade or
business in the United States.

“(3) NOT TO EXCEED EARNINGS AND PROFITS.—
The subpart F income of any controlled foreign corpora-
tion for any taxable year shall not exceed the earnings
and profits of such corporation for such year.

“(b) INCOME FROM INSURANCE OF UNITED STATES
RISKS.—

“(1) GENERAL RULE.—If a controlled foreign cor-
poration receives premiums or other consideration in

1 respect of any reinsurance or the issuing of any insurance
2 or annuity contract—

3 “(A) in connection with property in, or resi-
4 dents of, the United States, or

5 “(B) in connection with property not in, or
6 nonresidents of, the United States as the result of
7 any arrangement whereby another corporation re-
8 ceives a substantially equal amount of premiums or
9 other consideration in respect of any reinsurance or
10 the issuing of any insurance or annuity contract in
11 connection with property in, or residents of, the
12 United States,

13 then for purposes of subsection (a) (1) (A), the term
14 ‘income derived from the insurance of United States
15 risks’ means that income which (subject to the modifi-
16 cations provided by subparagraphs (A), (B), and (C)
17 of paragraph (2)) would be taxed under subchapter L
18 of this chapter if such corporation were a domestic
19 corporation.

20 “(2) SPECIAL RULES.—For purposes of paragraph
21 (1) —

22 “(A) In the application of part I of subchapter
23 L, life insurance company taxable income is the
24 gain from operations as defined in section 809 (b).

1 “(B) A corporation which would, if it were a
2 domestic corporation, be taxable under part II of
3 subchapter L shall apply paragraph (1) as if it
4 were taxable under part III of subchapter L.

5 “(C) The following provisions of subchapter L
6 shall not apply:

7 “(i) Section 809 (d) (4) (operations loss
8 deduction).

9 “(ii) Section 809 (d) (5) (certain non-
10 participating contracts).

11 “(iii) Section 809 (d) (6) (group life,
12 accident, and health insurance).

13 “(iv) Section 809 (d) (10) (small busi-
14 ness deduction).

15 “(v) Section 817 (b) (gain on property
16 held on December 31, 1958, and certain sub-
17 stituted property acquired after 1958).

18 “(vi) Section 832 (b) (5) (certain capital
19 losses).

20 “(D) ‘Gross amount’ to the extent provided in
21 section 809 (c) (1) and (2), less ‘increase in
22 certain reserves’ as defined in section 809 (d) (2),
23 and ‘premiums earned’ as defined in section 832 (b)
24 (4) shall be taken into account only to the extent

1 they are in respect of any reinsurance or the issuing
 2 of any reinsurance or the issuing of any insurance
 3 or annuity contract described in paragraph (1).

4 “(E) All items of income (other than those
 5 taken into account under subparagraph (D)) and
 6 all items of expenses, losses, and deductions shall
 7 be properly allocated or apportioned under regula-
 8 tions prescribed by the Secretary or his delegate.

9 “(c) INCOME FROM UNITED STATES PATENTS, COPY-
 10 RIGHTS, AND EXCLUSIVE FORMULAS AND PROCESSES.—

11 “(1) GENERAL RULE.—For purposes of subsection
 12 (a) (1) (B), the term ‘income from United States
 13 patents, copyrights, and exclusive formulas and proc-
 14 esses’, means the amount of gross rentals, royalties, or
 15 other income derived from the license, sublicense, sale,
 16 exchange, use, or other means of exploitation of patents,
 17 copyrights, and exclusive formulas and processes—

18 “(A) substantially developed, created, or pro-
 19 duced in the United States, or

20 “(B) acquired from any United States person
 21 which, directly or indirectly, owns or controls, or
 22 is owned or controlled by, or is under common
 23 ownership or control with, the controlled foreign
 24 corporation,

1 less the cost and expense allowance defined in para-
2 graph (2).

3 “(2) COST AND EXPENSE ALLOWANCE.—An al-
4 lowance shall be made, in accordance with regulations
5 prescribed by the Secretary or his delegate, for ordinary
6 and necessary expenses incurred by the controlled foreign
7 corporation in the receipt or production of the income
8 described in paragraph (1), including taxes and any
9 amortization or depreciation of the cost to such corpo-
10 ration of such property or rights described in paragraph
11 (1), but not including any production, manufacturing,
12 or similar expenses incurred in the use or other means
13 of exploitation of such property or rights.

14 “(3) DETERMINATION OF INCOME FROM USE.—
15 The income from use or other means of exploitation by
16 the controlled foreign corporation of the property or
17 right described in paragraph (1) shall be the amount
18 which would be obtained as a gross rent, royalty, or
19 other payment in an arm's length transaction with an
20 unrelated person for similar use or exploitation, of the
21 property or right.

22 “(d) NET FOREIGN BASE COMPANY INCOME.—For
23 purposes of subsection (a) (1) (C), the term ‘net foreign
24 base company income’ means—

1 “(1) the foreign base company income for the tax-
2 able year, determined under subsection (e), reduced
3 by

4 “(2) the increase in investment in qualified prop-
5 erty in less developed countries for the taxable year,
6 determined under subsection (f).

7 “(e) FOREIGN BASE COMPANY INCOME.—

8 “(1) IN GENERAL.—For purposes of subsection
9 (d) (1), the term ‘foreign base company income’ means
10 the foreign personal holding company income (as de-
11 fined in section 553) for the taxable year, modified and
12 adjusted as provided in this subsection.

13 “(2) CERTAIN SALES INCOME INCLUDED.—The
14 term ‘foreign base company income’ includes foreign
15 base company sales income if, for the taxable year, such
16 income is equal to at least 20 percent of the gross income
17 of the foreign corporation (not including for this purpose
18 other foreign base company income under this subsec-
19 tion). For purposes of this paragraph, the term ‘foreign
20 base company sales income’ means income (whether in
21 the form of profits, commissions, fees, or otherwise)
22 derived in connection with the purchase of personal
23 property from a related person and its sale to any per-
24 son, or the purchase of personal property from any
25 person and its sale to a related person, where—

1 “(A) the property which is purchased is manu-
2 factured, produced, grown, or extracted outside
3 the country under the laws of which the controlled
4 foreign corporation is created or organized, and

5 “(B) the property is sold for use, consumption,
6 or disposition outside such foreign country.

7 For purposes of the preceding sentence, a person is a
8 related person with respect to the controlled foreign
9 corporation if he, directly or indirectly, owns or con-
10 trols, or is owned or controlled by, or is under common
11 ownership or control with, the controlled foreign
12 corporation.

13 “(3) RENTS INCLUDED WITHOUT REGARD TO 50-
14 PERCENT LIMITATION.—All rents shall be included in
15 foreign base company income without regard to whether
16 or not such rents constitute more than 50 percent of
17 gross income.

18 “(4) INSURANCE AND PATENT INCOME EX-
19 CLUDED.—The term ‘foreign base company income’ does
20 not include any income derived from insurance of United
21 States risks (as determined under subsection (b)) or
22 income from United States patents, copyrights, and ex-
23 clusive formulas and processes (as determined under
24 subsection (c)).

1 “(5) INCOME OF CERTAIN BANKS AND BANK-
2 CONTROLLED CORPORATIONS EXCLUDED.—The term
3 ‘foreign base company income’ does not include—

4 “(A) the income of any corporation de-
5 scribed in section 552(b) (relating to excep-
6 tion for banks and exempt corporations), or

7 “(B) the income of any foreign corporation
8 if 50 percent or more of the fair market value of
9 its outstanding stock is owned directly or indirectly
10 by a domestic corporation which is either organ-
11 ized under section 25(a) of the Federal Reserve
12 Act (12 U.S.C., secs. 611–631), or has an agree-
13 ment or understanding with the Board of Gover-
14 nors of the Federal Reserve System under section
15 25 of the Federal Reserve Act (12 U.S.C., secs.
16 601–604), if all of the stock (except qualifying
17 shares) of the domestic corporation is owned by a
18 national or State bank which is a member of the
19 Federal Reserve System.

20 “(6) SPECIAL RULE WHERE FOREIGN BASE COM-
21 PANY INCOME IS LESS THAN 20 PERCENT OR MORE
22 THAN 80 PERCENT OF GROSS INCOME.—For purposes
23 of this subsection—

24 “(A) If the foreign base company income
25 (determined without regard to paragraph (7))

1 is less than 20 percent of gross income, no part of
2 the gross income of the taxable year shall be
3 treated as foreign base company income.

4 “(B) If the foreign base company income
5 (determined without regard to paragraph (7))
6 exceeds 80 percent of gross income, the entire
7 gross income of the taxable year shall be taken
8 into account in determining foreign base company
9 income.

10 “(7) DEDUCTIONS TO BE TAKEN INTO AC-
11 COUNT.—The foreign base company income for the tax-
12 able year shall be reduced so as to take into account
13 deductions (including taxes) properly allocable to such
14 income.

15 “(f) INVESTMENT IN QUALIFIED PROPERTY IN LESS
16 DEVELOPED COUNTRIES.—

17 “(1) GENERAL RULE.—For purposes of subsection
18 (d) (2), the increase in investment in qualified property
19 in less developed countries for any taxable year is the
20 amount by which—

21 “(A) the aggregate amount of property de-
22 scribed in sections 953 (b) (2) (C) and (D) and
23 property (including money) which is located out-
24 side the United States and is ordinary and necessary
25 for the active conduct of a qualified trade or business

1 described in section 953 (b) (3) (A) (ii) held at
2 the close of the taxable year, exceeds

3 “(B) the aggregate amount of property de-
4 scribed in subparagraph (A) held at the close of
5 the preceding taxable year.

6 “(2) INVESTMENTS AFTER CLOSE OF YEAR.—
7 Under regulations prescribed by the Secretary or his
8 delegate, a controlled foreign corporation may elect to
9 make the determinations under subparagraphs (A)
10 and (B) of paragraph (1) as of the close of the 75th
11 day after the close of each taxable year.

12 “(3) AMOUNT ATTRIBUTABLE TO PROPERTY.—
13 The amount taken into account under paragraph (1)
14 with respect to any property shall be its adjusted basis,
15 reduced by any liability to which the property is subject.

16 **“SEC. 953. INVESTMENT OF EARNINGS IN NONQUALIFIED**
17 **PROPERTY.**

18 “(a) GENERAL RULES.—For purposes of this subpart—

19 “(1) AMOUNT OF INVESTMENT.—The amount of
20 earnings of a controlled foreign corporation invested in
21 nonqualified property at the close of any taxable year
22 is the aggregate amount of such property held at the
23 close of the taxable year, to the extent such amount
24 does not exceed the sum of (A) the earnings and profits
25 for the taxable year, and (B) the earnings and profits

1 accumulated for prior taxable years beginning after
2 December 31, 1962.

3 “(2) PRO RATA SHARE OF INCREASE FOR YEAR.—

4 In the case of any United States person, the pro rata
5 share of the increase for any taxable year in the earn-
6 ings of a controlled foreign corporation invested in a
7 nonqualified property is the amount determined by sub-
8 tracting—

9 “(A) his pro rata share of the amount deter-
10 mined under paragraph (1) for the close of the
11 preceding taxable year, reduced by amounts paid
12 during the taxable year to which section 956 (c) (1)
13 applies, from

14 “(B) his pro rata share of the amount deter-
15 mined under paragraph (1) for the close of the
16 taxable year.

17 “(3) AMOUNT ATTRIBUTABLE TO PROPERTY.—

18 The amount taken into account under paragraph (1) or
19 (2) with respect to any property shall be its adjusted
20 basis, reduced by any liability to which the property
21 is subject.

22 “(b) NONQUALIFIED PROPERTY DEFINED.—For pur-
23 poses of this subpart—

24 “(1) GENERAL RULE.—The term ‘nonqualified
25 property’ means any money or other property (tangible

1 or intangible) acquired after December 31, 1962,
2 which is not qualified property.

3 “(2) QUALIFIED PROPERTY.—The term ‘qualified
4 property’ means—

5 “(A) Any money or other property which is
6 located outside the United States and is ordinary
7 and necessary for the active conduct of a qualified
8 trade or business (as determined under paragraph
9 (3)) carried on by the controlled foreign corpora-
10 tion.

11 “(B) Property which would qualify under sub-
12 paragraph (A) except for the fact that it is located
13 in the United States, but only if such property is—

14 “(i) obligations of the United States,
15 money, or deposits with persons carrying on
16 the banking business;

17 “(ii) property purchased in the United
18 States for export to, or for use in, foreign
19 countries; or

20 “(iii) any loan arising in connection with
21 the sale of property if the amount of such loan
22 outstanding at no time during the taxable year
23 exceeds the amount which would be ordinary
24 and necessary to carry on the trade or business
25 of both the lending corporation and the borrow-

1 ing United States person had the sale been
2 made between unrelated persons.

3 “(C) Stock owned by the controlled foreign
4 corporation in another controlled foreign corpora-
5 tion in which it owns at least 10 percent of the vot-
6 ing stock and 10 percent of the value of all classes of
7 stock and in which it together with four or fewer
8 United States persons, owns, directly or indirectly,
9 more than 50 percent of the voting stock (unless
10 under the laws of a less developed country such per-
11 centage of ownership is not permitted, in which
12 case such lesser percentage as is permitted) ; but this
13 subparagraph shall apply only if—

14 “(i) substantially all of the property of
15 such other controlled foreign corporation is or-
16 dinary and necessary for the active conduct of
17 a trade or business engaged in by it almost
18 wholly within a less developed country or
19 countries, and

20 “(ii) such other controlled foreign cor-
21 poration is created or organized under the laws
22 of one of such countries in which it is so en-
23 gaged.

24 “(D) Any investment which is required
25 because of restrictions imposed by a less developed

1 country, and any investment which, when made,
2 was so required and which would result in substan-
3 tial losses if withdrawn.

4 “(3) QUALIFIED TRADE OR BUSINESS.—

5 “(A) A trade or business is a qualified trade or
6 business if such trade or business (or substantially
7 the same trade or business) —

8 “(i) is carried on by the controlled foreign
9 corporation outside the United States and has
10 been so carried on by such corporation, while
11 controlled by substantially the same United
12 States persons since December 31, 1962, or
13 during the 5-year period ending with the close
14 of the preceding taxable year, or

15 “(ii) is carried on by the controlled foreign
16 corporation almost wholly within a less devel-
17 oped country or countries.

18 “(B) A trade or business which is a qualified
19 trade or business for a corporation in which the
20 controlled foreign corporation owns at least 80 per-
21 cent of the total combined voting power of all classes
22 of stock entitled to vote and at least 80 percent of

1 the total value of all classes of stock shall be treated
2 as a qualified trade or business for the controlled
3 foreign corporation if such percentage of stock was
4 owned continuously since December 31, 1962, or
5 during the 5-year period ending with the close of
6 the preceding taxable year.

7 “(4) SITUS OF CERTAIN PROPERTY.—Property
8 which is an obligation of, or pledges and guarantees
9 made with respect to obligations of, United States persons
10 shall be considered as property located in the United
11 States.

12 “(5) LESS DEVELOPED COUNTRY DEFINED.—The
13 term ‘less developed country’ means (in respect of any
14 foreign corporation) any foreign country (other than
15 an area within the Sino-Soviet bloc) or any possession
16 of the United States, with respect to which on the first
17 day of the taxable year, there is in effect an Executive
18 order by the President of the United States designating
19 such country or possession as an economically less de-
20 veloped country for purposes of this subpart. For pur-
21 poses of the preceding sentence, an oversea territory,
22 department, province, or possession may be treated as

1 a separate country. No designation shall be made under
2 this paragraph with respect to—

3	Australia	Liechtenstein
4	Austria	Luxembourg
5	Belgium	Monaco
6	Canada	Netherlands
7	Denmark	New Zealand
8	France	Norway
9	Germany (Federal	Union of South Africa
10	Republic)	San Marino
11	Hong Kong	Sweden
12	Italy	Switzerland
13	Japan	United Kingdom

14 **“SEC. 954. CONTROLLED FOREIGN CORPORATIONS.**

15 “(a) GENERAL RULE.—For purposes of this subpart,
16 the term ‘controlled foreign corporation’ means any foreign
17 corporation of which more than 50 percent of the total com-
18 bined voting power of all classes of stock entitled to vote is
19 owned, directly or indirectly (within the meaning of section
20 955 (b)), by United States persons on any day during the
21 taxable year of such foreign corporation.

22 “(b) SPECIAL RULE FOR INSURANCE.—For purposes
23 only of taking into account income described in section
24 952 (a) (1) (A) (relating to income derived from insurance
25 of United States risks), the term ‘controlled foreign corpora-

tion' includes not only a foreign corporation as defined by subsection (a) but also one of which more than 25 percent of the total combined voting power of all classes of stock is owned, directly or indirectly (within the meaning of section 955 (b)), by United States persons on any day during the taxable year of such corporation, if the gross amount of premiums or other consideration in respect of reinsurance or the issuing of insurance or annuity contracts in connection with property in, or residents of, the United States, exceeds 75 percent of the gross amount of all premiums or other consideration in respect of all risks.

“(c) SPECIAL RULE FOR CERTAIN LESS DEVELOPED COUNTRIES.—In the case of any foreign corporation to which section 953 (b) (2) (C) applies, the maximum percentage of ownership permitted under the laws of a less developed country shall be considered, in lieu of the more than 50 percent requirement in subsection (a), the percentage required under subsection (a) in order for the corporation to be classified as a controlled foreign corporation.

“SEC. 955. RULES FOR DETERMINING STOCK OWNERSHIP.

“(a) FOR PURPOSES OF SECTION 951 (a).—

“(1) GENERAL RULE.—For purposes of section 951 (a), stock owned means—

“(A) stock owned directly, and

1 “(B) stock owned with the application of para-
2 graph (2).

3 “(2) STOCK OWNERSHIP THROUGH FOREIGN EN-
4 TITIES.—For purposes of subparagraph (B) of para-
5 graph (1), stock owned, directly or indirectly, by or
6 for a foreign corporation, foreign partnership, or foreign
7 trust or foreign estate (within the meaning of section
8 7701 (a) (31)) shall be considered as being owned pro-
9 portionately by its shareholders, partners, or benefici-
10 aries. Stock considered to be owned by a person by reason
11 of the application of the preceding sentence shall, for
12 purposes of applying such sentence, be treated as actually
13 owned by such person.

14 “(3) SPECIAL RULE FOR MUTUAL INSURANCE
15 COMPANIES.—For purposes of applying paragraph (1)
16 in the case of a foreign mutual insurance company, the
17 term ‘stock’ shall include any certificate entitling the
18 holder to voting power in the corporation.

19 “(b) OTHER PROVISIONS.—For purposes of sections 951
20 (b) , 952 (a) (1) (C) , and 954, section 318 (a) (relating to
21 constructive ownership of stock) shall apply to the extent
22 that the effect is to subject a United States person to the
23 requirement of section 951 (a) , to treat 5 or fewer United
24 States persons as owning more than 50 percent of all classes
25 of stock entitled to vote of a controlled foreign corporation,

1 or to make a foreign corporation a controlled foreign cor-
2 poration under section 954, except—

3 “(1) In applying paragraph (1) (A) of section
4 318 (a), stock owned by a nonresident alien individual
5 (other than a foreign trust or foreign estate) shall not
6 be considered as owned by a citizen or by a resident
7 alien individual.

8 “(2) In applying the first sentence of subpara-
9 graphs (A) and (B), and in applying clause (i) of
10 subparagraph (C), of section 318 (a) (2) —

11 “(A) if a partnership, estate, trust, or corpora-
12 tion owns, directly or indirectly, more than 50 per-
13 cent of the total combined voting power of all classes
14 of stock entitled to vote of a corporation, it shall be
15 considered as owning all the stock entitled to vote,
16 and

17 “(B) if a partnership, estate, trust, or corpora-
18 tion owns, directly or indirectly, more than 50 per-
19 cent of the total value of shares of all classes of stock
20 of a corporation, it shall be considered as owning
21 the total value of all of the outstanding stock of such
22 corporation. The application of this subparagraph
23 shall not have the effect of increasing voting power
24 of a partner, beneficiary, or shareholder, for pur-
25 poses of subparagraph (A).

1 “(3) Stock owned by a partnership, estate, trust,
 2 or corporation, by reason of the application of the second
 3 sentence of subparagraphs (A) and (B), and the appli-
 4 cation of clause (ii) of subparagraph (C), of section
 5 318 (a) (2), shall not be considered as owned by such
 6 partnership, estate, trust, or corporation, for the purposes
 7 of applying the first sentence of subparagraphs (A) and
 8 (B), and in applying clause (i) of subparagraph (C),
 9 of section 318 (a) (2).

10 “(4) In applying clause (i) of subparagraph (C)
 11 of section 318 (a) (2), the 50-percent limitation con-
 12 tained in subparagraph (C) shall not apply.

13 **“SEC. 956. EXCLUSION FROM GROSS INCOME OF PREVI-**
 14 **OUSLY TAXED EARNINGS AND PROFITS.**

15 “(a) EXCLUSION FROM GROSS INCOME OF UNITED
 16 STATES PERSONS.—For purposes of this chapter, the earn-
 17 ings and profits for a taxable year of a foreign corporation
 18 attributable to amounts which are, or have been, included in
 19 the gross income of a United States person under section
 20 951 (a) shall not, when—

21 “(1) such amounts are distributed to, or

22 “(2) such amounts would, but for this subsection,
 23 be included under section 951 (a) (1) (B) in the gross
 24 income of,

25 such person (or any other United States person who acquires

1 from any person any portion of the interest of such United
2 States person in such foreign corporation, but only to the ex-
3 tent of such portion, and subject to such proof of the identity
4 of such interest as the Secretary or his delegate may by regu-
5 lations prescribe) directly, or indirectly through a chain of
6 ownership described under section 955 (a) , be again included
7 in the gross income of such United States person (or of such
8 other United States person) .

9 “(b) EXCLUSION FROM GROSS INCOME OF CERTAIN
10 FOREIGN SUBSIDIARIES.—For purposes of section 951 (a) ,
11 the earnings and profits for a taxable year of a controlled
12 foreign corporation attributable to amounts which are, or
13 have been, included in the gross income of a United States
14 person under section 951 (a) , shall not, when distributed
15 through a chain of ownership described under section 955
16 (a) , be also included in the gross income of another con-
17 trolled foreign corporation in such chain for purposes of the
18 application of section 951 (a) to such other controlled foreign
19 corporation with respect to such United States person (or to
20 any other United States person who acquires from any per-
21 son any portion of the interest of such United States person
22 in the controlled foreign corporation, but only to the extent of
23 such portion, and subject to such proof of identity of such
24 interest as the Secretary or his delegate may prescribe by
25 regulations) .

1 “(c) ALLOCATION OF DISTRIBUTIONS.—For purposes
2 of subsections (a) and (b), section 316(a) shall be ap-
3 plied by applying paragraph (2) thereof, and then para-
4 graph (1) thereof—

5 “(1) first to earnings and profits attributable to
6 amounts included in gross income under section 951
7 (a) (1) (B) (or which would have been included except
8 for section 956(a) (2)),

9 “(2) then to earnings and profits attributable to
10 amounts included in gross income under section 951 (a)
11 (1) (A) (but reduced by amounts not included under
12 section 951 (a) (1) (B) because of the exclusion in sec-
13 tion 956(a) (2)), and

14 “(3) then to other earnings and profits.

15 “(d) DISTRIBUTIONS EXCLUDED FROM GROSS IN-
16 COME NOT TO BE TREATED AS DIVIDENDS.—Except as pro-
17 vided in section 957(a) (3), any distribution excluded from
18 gross income under subsection (a) shall be treated, for pur-
19 poses of this chapter, as a distribution which is not a
20 dividend.

21 “SEC. 957. SPECIAL RULES FOR FOREIGN TAX CREDIT.

22 “(a) TAXES PAID BY A FOREIGN CORPORATION.—

23 “(1) GENERAL RULE.—For purposes of subpart A
24 of this part, if there is included, under section 951(a),

1 in the gross income of a domestic corporation any
2 amount attributable to earnings and profits—

3 “(A) of a foreign corporation at least 10 per-
4 cent of the voting stock of which is directly owned
5 by such domestic corporation, or

6 “(B) of a foreign corporation at least 50 per-
7 cent of the voting stock of which is directly owned
8 by a foreign corporation at least 10 percent of the
9 voting stock of which is in turn directly owned by
10 such domestic corporation,

11 then, under regulations prescribed by the Secretary or
12 his delegate, such domestic corporation shall be deemed
13 to have paid the same proportion of the total income,
14 war profits, and excess profits taxes paid (or deemed
15 paid, if, paragraph (4) applies) to a foreign country
16 or possession of the United States for the taxable year
17 which the amount of earnings and profits of such foreign
18 corporation so included in gross income of the domestic
19 corporation bears to the entire amount of the total earn-
20 ings and profits of such foreign corporation for such
21 taxable year.

22 “(2) TAXES PREVIOUSLY DEEMED PAID BY DO-
23 MESTIC CORPORATION.—If a domestic corporation re-

1 ceives a distribution from a foreign corporation, any
2 portion of which is excluded from gross income under
3 section 956, the income, war profits, and excess profits
4 taxes paid or deemed paid by such foreign corporation
5 to any foreign country or to any possession of the United
6 States in connection with the earnings and profits of
7 such foreign corporation from which such distribution
8 is made shall not be taken into account for purposes
9 of section 902, to the extent such taxes were deemed
10 paid by such domestic corporation under paragraph (1)
11 for any prior taxable year.

12 “(3) TAXES PAID BY FOREIGN CORPORATION AND
13 NOT PREVIOUSLY DEEMED PAID BY DOMESTIC CORPORA-
14 TION.—Any portion of a distribution from a foreign cor-
15 poration received by a domestic corporation which is
16 excluded from gross income under section 956 (a) shall
17 be treated by the domestic corporation as a dividend,
18 solely for purposes of taking into account under section 902
19 any income, war profits, or excess profits taxes paid to
20 any foreign country or to any possession of the United
21 States, on or with respect to the accumulated profits of
22 such foreign corporation from which such distribution is
23 made, which were not deemed paid by the domestic
24 corporation under paragraph (1) for any prior taxable
25 year.

“ (4) TAXES PAID BY A FOREIGN SUBSIDIARY.—If subparagraph (A) of paragraph (1) applies with respect to an amount included in gross income under section 951 (a) for a taxable year, then such amount shall be considered a dividend for purpose of the application of section 902 (b) .

“ (5) INCLUSION IN GROSS INCOME.—

“For inclusion in gross income of amount equal to taxes deemed paid under paragraph (1), see section 78.

“ (b) SPECIAL RULES FOR FOREIGN TAX CREDIT IN YEAR OF RECEIPT OF PREVIOUSLY TAXED EARNINGS AND PROFITS.—

“ (1) INCREASE IN SECTION 904 LIMITATION.—In the case of any taxpayer who—

“ (A) either (i) chose to have the benefits of subpart A of this part for a taxable year in which he was required under section 951 (a) to include in his gross income an amount in respect of a controlled foreign corporation, or (ii) did not pay or accrue for such taxable year any income, war profits, or excess profits taxes to any foreign country or to any possession of the United States, and

“ (B) chooses to have the benefits of subpart A of this part for the taxable year in which he receives a distribution or amount which is excluded

1 from gross income under section 956 (a) and which
2 is attributable to earnings and profits of the con-
3 trolled foreign corporation which was included in
4 his gross income for the taxable year referred to in
5 subparagraph (A), and

6 “(C) for the taxable year in which such dis-
7 tribution or amount is received, pays, or is deemed
8 to have paid, or accrues income, war profits, or ex-
9 cess profits taxes to a foreign country or to any
10 possession of the United States with respect to such
11 distribution or amount,

12 the applicable limitation under section 904 for the tax-
13 able year in which such distribution or amount is re-
14 ceived shall be increased as provided in paragraph (2),
15 but such increase shall not exceed the amount of such
16 taxes paid, or deemed paid, or accrued with respect
17 to such distribution or amount.

18 “(2) AMOUNT OF INCREASE.—The amount of in-
19 crease of the applicable limitation under section 904 (a)
20 for the taxable year in which the distribution or amount
21 referred to in paragraph (1) (B) is received shall be
22 an amount equal to—

23 “(A) the amount by which the applicable lim-
24 itation under section 904 (a) for the taxable year
25 referred to in paragraph (1) (A) was increased by

reason of the inclusion in gross income under section 951 (a) of the amount in respect of the controlled foreign corporation, reduced by

“(B) the amount of any income, war profits, and excess profits taxes paid, or deemed paid, or accrued to any foreign country or possession of the United States which were allowable as a credit under section 901 for the taxable year referred to in paragraph (1) (A) and which would not have been allowable but for the inclusion in gross income of the amount described in subparagraph (A).

“(3) CASES IN WHICH TAXES NOT TO BE ALLOWED AS DEDUCTION.—In the case of any taxpayer who—

“(A) chose to have the benefits of subpart A of this part for a taxable year in which he was required under section 951 (a) to include in his gross income an amount in respect of a controlled foreign corporation, and

“(B) does not choose to have the benefits of subpart A of this part for the taxable year in which he receives a distribution or amount which is excluded from gross income under section 956 (a) and which is attributable to earnings and profits of the controlled foreign corporation which was included

1 in his gross income for the taxable year referred to
2 in subparagraph (A),
3 no deduction shall be allowed under section 164 for the
4 taxable year in which such distribution or amount is
5 received for any income, war profits, or excess profits
6 taxes paid or accrued to any foreign country or to any
7 possession of the United States on or with respect to
8 such distribution or amount.

9 “(4) INSUFFICIENT TAXABLE INCOME.—If an in-
10 crease in the limitation under this subsection exceeds the
11 tax imposed by this chapter for such year, the amount
12 of such excess shall be deemed an overpayment of tax
13 for such year.

14 **“SEC. 958. ADJUSTMENTS TO BASIS OF STOCK IN CON-**
15 **TROLLED FOREIGN CORPORATION AND OF**
16 **OTHER PROPERTY.**

17 “(a) INCREASE IN BASIS.—Under regulations pre-
18 scribed by the Secretary or his delegate, the basis of a United
19 States person’s stock in a controlled foreign corporation, and
20 the basis of property of a United States person by reason of
21 which he is considered under section 955 (a) (2) as owning
22 stock of a controlled foreign corporation, shall be increased
23 by the amount required to be included in his gross income
24 under section 951 (a) with respect to such stock or with
25 respect to such property, as the case may be, but only to the

1 extent to which such amount was included in the gross
2 income of such person.

3 “(b) REDUCTION IN BASIS.—

4 “(1) IN GENERAL.—Under regulations prescribed
5 by the Secretary or his delegate, the adjusted basis of
6 stock or other property with respect to which a United
7 States person receives an amount which is excluded from
8 gross income under section 956 (a) shall be reduced by
9 the amount so excluded.

10 “(2) AMOUNT IN EXCESS OF BASIS.—To the ex-
11 tent that an amount excluded from gross income under
12 section 956 (a) exceeds the adjusted basis of the stock
13 or other property with respect to which it is received,
14 the amount shall be treated as gain from the sale or
15 exchange of property.”

16 (b) TECHNICAL AND CLERICAL AMENDMENTS.—

17 (1) Section 551 (b) (relating to foreign personal
18 holding company income included in gross income of
19 United States shareholders) is amended by adding at
20 the end thereof the following new sentence: “The amount
21 included in the gross income of any United States share-
22 holder for any taxable year under the preceding sen-
23 tence shall be reduced by such shareholder’s proportion-
24 ate share of the undistributed personal holding company
25 income which is included in his gross income under

1 section 951 (a) (1) (A) (relating to amounts included
2 in gross income of United States persons) for such tax-
3 able year as his pro rata share of the subpart F income
4 of the company.”

5 (2) Section 901 (relating to foreign tax credit) is
6 amended by striking out “section 902” and inserting
7 in lieu thereof “sections 902 and 957”.

8 (3) Section 902 (e) is amended to read as follows:

9 “(e) CROSS REFERENCES.—

“(1) For application of subsections (a) and (b) with respect to taxes deemed paid in a prior taxable year by a United States person with respect to a controlled foreign corporation, see section 957.

“(2) For reduction of credit with respect to dividends paid out of accumulated profits for years for which certain information is not furnished, see section 6038.”

10 (4) Section 904 (f) is amended to read as follows:

11 “(f) CROSS REFERENCES.—

“(1) For increase of applicable limitation under subsection (a) for taxes paid with respect to amounts received which were included in the gross income of the taxpayer for a prior taxable year as a United States person with respect to a controlled foreign corporation, see section 957(b).

“(2) For special rule relating to the application of the credit provided by section 901 in the case of affiliated groups which include Western Hemisphere trade corporations for years in which the limitation provided by subsection (a)(2) applies, see section 1503(d).”

12 (5) The table of subparts for part III of subchapter
13 N of chapter 1 is amended by adding at the end thereof
14 the following:

“Subpart F. Controlled foreign corporations.”

(6) Section 1016(a) (relating to adjustments to basis) is amended—

(A) by striking out the period at the end of paragraph (18) and inserting in lieu thereof a semicolon; and

(B) by adding after paragraph (18) the following new paragraph:

“(19) to the extent provided in section 958 in the case of stock in controlled foreign corporations (or foreign corporations which were controlled foreign corporations) and of property by reason of which a person is considered as owning such stock.”

(c) **EFFECTIVE DATE.**—The amendments made by this section shall apply with respect to taxable years of foreign corporations beginning after December 31, 1962, and to taxable years of United States persons within which or with which such taxable years of such foreign corporations end.

SEC. 14. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE PROPERTY.

(a) **IN GENERAL.**—

(1) Part IV of subchapter P of chapter 1 (relating to special rules for determining capital gains and losses)

1 is amended by adding at the end thereof the following
2 new section:

3 **“SEC. 1245. GAIN FROM DISPOSITIONS OF CERTAIN DE-**
4 **PRECIABLE PROPERTY.**

5 **“(a) GENERAL RULE.—**

6 **“(1) ORDINARY INCOME.—**Except as otherwise
7 provided in this section, if section 1245 property is dis-
8 posed of after the date of the enactment of the Revenue
9 Act of 1962, the amount by which the lower of—

10 **“(A) the recomputed basis of the property, or**

11 **“(B) (i) in the case of a sale, exchange, or**
12 **involuntary conversion, the amount realized, or**

13 **“(ii) in the case of any other disposition, the**
14 **fair market value of such property,**

15 **exceeds the adjusted basis of such property shall be**
16 **treated as gain from the sale or exchange of property**
17 **which is neither a capital asset nor property described in**
18 **section 1231. Such gain shall be recognized notwith-**
19 **standing any other provision of this subtitle.**

20 **“(2) RECOMPUTED BASIS.—**For purposes of this
21 section, the term ‘recomputed basis’ means, with respect
22 to any property, its adjusted basis recomputed by adding
23 thereto all adjustments, for taxable years beginning after
24 December 31, 1961, reflected in such adjusted basis on
25 account of deductions (whether in respect of the same

1 or other property) allowed or allowable to the taxpayer
2 or to any other person for depreciation, or for amortiza-
3 tion under section 168. For purposes of the preceding
4 sentence, if the taxpayer can establish by adequate
5 records or other sufficient evidence that the amount
6 allowed for depreciation, or for amortization under sec-
7 tion 168, for any taxable year was less than the amount
8 allowable, the amount added for such taxable year shall
9 be the amount allowed.

10 “(3) SECTION 1245 PROPERTY.—For purposes
11 of this section, the term ‘section 1245 property’ means
12 any property (other than livestock) which is or has
13 been property of a character subject to the allowance
14 for depreciation provided in section 167 and is either—

15 “(A) personal property, or

16 “(B) other property (not including a building
17 or its structural components) but only if such other
18 property is tangible and has an adjusted basis in
19 which there are reflected adjustments described in
20 paragraph (2) for a period in which such prop-
21 erty (or other property) —

22 “(i) was used as an integral part of manu-
23 facturing, production, or extraction or of fur-
24 nishing transportation, communications, electri-

1 cal energy, gas, water, or sewage disposal serv-
2 ices, or

3 “(ii) constituted research or storage facili-
4 ties used in connection with any of the activi-
5 ties referred to in clause (i).

6 “(b) EXCEPTIONS AND LIMITATIONS.—

7 “(1) GIFTS.—Subsection (a) shall not apply to a
8 disposition by gift.

9 “(2) TRANSFERS AT DEATH.—Except as provided
10 in section 691 (relating to income in respect of a de-
11 cedent), subsection (a) shall not apply to a transfer at
12 death.

13 “(3) CERTAIN TAX-FREE TRANSACTIONS.—If the
14 basis of property in the hands of a transferee is deter-
15 mined by reference to its basis in the hands of the trans-
16 feror by reason of the application of section 332, 351,
17 361, 371 (a), 374 (a), 721, or 731, then the amount of
18 gain taken into account by the transferor under subsec-
19 tion (a) (1) shall not exceed the amount of gain recog-
20 nized to the transferor on the transfer of such property
21 (determined without regard to this section). This para-
22 graph shall not apply to a disposition to an organization
23 (other than a cooperative described in section 521)
24 which is exempt from the tax imposed by this chapter.

25 “(4) LIKE KIND EXCHANGES; INVOLUNTARY CON-

1 VERSIONS, ETC.—If property is disposed of and gain
 2 (determined without regard to this section) is not rec-
 3 ognized in whole or in part under section 1031 or 1033,
 4 then the amount of gain taken into account by the trans-
 5 feror under subsection (a) (1) shall not exceed the
 6 sum of—

7 “(A) the amount of gain recognized on such
 8 disposition (determined without regard to this sec-
 9 tion), plus

10 “(B) the fair market value of property acquired
 11 which is not section 1245 property and which is not
 12 taken into account under subparagraph (A).

13 “(5) SECTION 1071 AND 1081 TRANSACTIONS.—
 14 Under regulations prescribed by the Secretary or his
 15 delegate, rules consistent with paragraphs (3) and (4)
 16 of this subsection shall apply in the case of transactions
 17 described in section 1071 (relating to gain from sale
 18 or exchange to effectuate policies of FCC) or section
 19 1081 (relating to exchanges in obedience to SEC
 20 orders).

21 “(6) PROPERTY DISTRIBUTED BY A PARTNERSHIP
 22 TO A PARTNER.—

23 “(A) IN GENERAL.—For purposes of this sec-
 24 tion, the basis of section 1245 property distributed
 25 by a partnership to a partner shall be deemed to

1 be determined by reference to the adjusted basis of
2 such property to the partnership.

3 “(B) ADJUSTMENTS ADDED BACK.—In the
4 case of any property described in subparagraph
5 (A), for purposes of computing the recomputed
6 basis of such property the amount of the adjustments
7 added back for periods before the distribution by
8 the partnership shall be—

9 “(i) the amount of the gain to which sub-
10 section (a) would have applied if such property
11 had been sold by the partnership immediately
12 before the distribution at its fair market value
13 at such time, reduced by

14 “(ii) the amount of such gain to which
15 section 751 (b) applied.

16 “(c) ADJUSTMENTS TO BASIS.—The Secretary or his
17 delegate shall prescribe such regulations as he may deem
18 necessary to provide for adjustments to the basis of property
19 to reflect gain recognized under subsection (a).

20 “(d) APPLICATION OF SECTION.—This section shall
21 apply notwithstanding any other provision of this subtitle.”

22 (2) The table of sections for such part IV is
23 amended by adding at the end thereof the following:

 “Sec. 1245. Gain from dispositions of certain depreciable
 property.”

1 (b) CHANGE IN METHOD OF DEPRECIATION.—Sub-
2 section (e) of section 167 (relating to depreciation) is
3 amended to read as follows:

4 “(e) CHANGE IN METHOD.—

5 “(1) CHANGE FROM DECLINING BALANCE
6 METHOD.—In the absence of an agreement under sub-
7 section (d) containing a provision to the contrary, a
8 taxpayer may at any time elect in accordance with regu-
9 lations prescribed by the Secretary or his delegate to
10 change from the method of depreciation described in sub-
11 section (b) (2) to the method described in subsection
12 (b) (1).

13 “(2) CHANGE WITH RESPECT TO SECTION 1245
14 PROPERTY.—A taxpayer may, within such period after
15 the date of the enactment of the Revenue Act of 1962
16 and in such manner as the Secretary or his delegate
17 shall by regulations prescribe, elect to change his method
18 of depreciation in respect of section 1245 property (as
19 defined in section 1245(a)(3)) from any declining
20 balance or sum of the years-digits method to the straight
21 line method. An election may be made under this
22 paragraph notwithstanding any provision to the con-
23 trary in an agreement under subsection (d).”

1 (c) SALVAGE VALUE OF PERSONAL PROPERTY.—

2 (1) AMOUNT TAKEN INTO ACCOUNT.—Section
3 167 (relating to depreciation) is amended by redesignat-
4 ing subsections (f), (g), and (h) as (g), (h), and
5 (i), respectively, and by inserting after subsection (e)
6 the following new subsection:

7 “(f) SALVAGE VALUE.—

8 “(1) GENERAL RULE.—Under regulations pre-
9 scribed by the Secretary or his delegate, a taxpayer may,
10 for purposes of computing the allowance under sub-
11 section (a) with respect to personal property, reduce
12 the amount taken into account as salvage value by an
13 amount which does not exceed 10 percent of the basis
14 of such property (as determined under subsection (g)
15 as of the time as of which such salvage value is required
16 to be determined).

17 “(2) PERSONAL PROPERTY DEFINED.—For pur-
18 poses of this subsection, the term ‘personal property’
19 means depreciable personal property (other than live-
20 stock) with a useful life of 3 years or more acquired after
21 the date of the enactment of the Revenue Act of 1962.”

22 (2) CONFORMING AMENDMENTS.—

23 (A) Sections 179 (d) (5) and 642 (e) are
24 each amended by striking out “167 (g)” and in-
25 serting in lieu thereof “167 (h)”.

1 (B) Section 179 (d) (8) is amended by strik-
 2 ing out “167 (f)” and inserting in lieu thereof
 3 “167 (g)”.

4 (d) SPECIAL RULE FOR CHARITABLE CONTRIBUTIONS
 5 OF SECTION 1245 PROPERTY.—Section 170 (relating to
 6 charitable, etc., contributions and gifts) is amended by re-
 7 designating subsections (e) and (f) as (f) and (g), re-
 8 spectively, and by inserting after subsection (d) the follow-
 9 ing new subsection:

10 “(e) SPECIAL RULE FOR CHARITABLE CONTRIBU-
 11 TIONS OF SECTION 1245 PROPERTY.—The amount of any
 12 charitable contribution taken into account under this section
 13 shall be reduced by the amount which would have been
 14 treated as gain to which section 1245 (a) applies if the prop-
 15 erty contributed had been sold at its fair market value
 16 (determined at the time of such contribution).”

17 (e) TECHNICAL AMENDMENTS.—

18 (1) SPECIAL RULE FOR PARTNERSHIPS.—Section
 19 751 (c) (relating to definition of “unrealized receiv-
 20 ables” for purposes of subchapter K) is amended by
 21 adding after paragraph (2) the following:

22 “For purposes of this section and sections 731, 736, and
 23 741, such term also includes section 1245 property (as de-
 24 fined in section 1245 (a) (3)), but only to the extent of the

1 amount which would be treated as gain to which section
 2 1245 (a) would apply if (at the time of the transaction de-
 3 scribed in this section or section 731, 736, or 741, as the
 4 case may be) such property had been sold by the partner-
 5 ship at its fair market value.”

6 (2) CORPORATE DISTRIBUTION OF PROPERTY.—
 7 Subsections (b) and (d) of section 301 (relating to
 8 amount distributed) are each amended by striking out
 9 “subsection (b) or (c) of section 311” and inserting in
 10 lieu thereof “subsection (b) or (c) of section 311 or
 11 under section 1245 (a) ”.

12 (3) EFFECT ON EARNINGS AND PROFITS.—Section
 13 312 (c) (3) (relating to adjustments of earnings and
 14 profits) is amended by striking out “subsection (b)
 15 or (c) of section 311” and inserting in lieu thereof
 16 “subsection (b) or (c) of section 311 or under sec-
 17 tion 1245 (a) ”.

18 (4) COLLAPSIBLE CORPORATIONS.—Section 341
 19 (e) (relating to collapsible corporations) is amended
 20 by inserting after paragraph (11) the following new
 21 paragraph:

22 “(12) NONAPPLICATION OF SECTION 1245(a).—
 23 For purposes of this subsection, the determination of
 24 whether gain from the sale or exchange of property
 25 would under any provision of this chapter be considered

as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 (b) shall be made without regard to the application of section 1245 (a).”

(5) INSTALLMENT OBLIGATIONS IN CERTAIN LIQUIDATIONS.—

(A) Section 453 (d) (4) (A) (relating to distribution of installment obligations in section 332 liquidations) is amended by adding at the end thereof the following new sentence: “If the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334 (b) (2) then the preceding sentence shall not apply to the extent that under paragraph (1) gain to the distributing corporation would be considered as gain to which section 1245 (a) applies.”

(B) Section 453 (d) (4) (B) (relating to distribution of installment obligations in liquidations to which section 337 applies) is amended by adding at the end thereof the following new sentence: “The preceding sentence shall not apply to the extent that under paragraph (1) gain to the distributing corporation would be considered as gain to which section 1245 (a) applies.”

(f) EFFECTIVE DATE.—The amendments made by this

1 section shall apply to taxable years beginning after December
2 31, 1961, and ending after the date of the enactment of this
3 Act.

4 **SEC. 15. FOREIGN INVESTMENT COMPANIES.**

5 (a) TREATMENT OF SALE OF STOCK OF FOREIGN
6 INVESTMENT COMPANIES.—

7 (1) IN GENERAL.—Part IV of subchapter P of
8 chapter 1 (relating to special rules for determining
9 capital gains and losses) is amended by adding after
10 section 1245 (as added by section 14 of this Act) the
11 following new sections:

12 **“SEC. 1246. GAIN ON FOREIGN INVESTMENT COMPANY**
13 **STOCK.**

14 “(a) TREATMENT OF GAIN AS ORDINARY INCOME.—

15 “(1) GENERAL RULE.—In the case of a sale or
16 exchange after December 31, 1962, of stock in a foreign
17 corporation which was a foreign investment company
18 (as defined in subsection (b)) at any time during the
19 period during which the taxpayer held such stock, any
20 gain shall be treated as gain from the sale or exchange
21 of property which is not a capital asset, to the extent
22 of the taxpayer's ratable share of the earnings and
23 profits of such corporation accumulated for taxable years
24 beginning after December 31, 1962.

25 “(2) RATABLE SHARE.—For purposes of this sec-

tion, the taxpayer's **ratable** share shall be determined under regulations prescribed by the Secretary or his delegate, but shall include only his ratable share of the accumulated earnings and profits of such corporation—

“(A) for the period during which the taxpayer held such stock, but

“(B) excluding such earnings and profits which were taxed to such taxpayer under section 951 or under section 551.

“(3) **TAXPAYER TO ESTABLISH EARNINGS AND PROFITS.**—Unless the taxpayer establishes the amount of the accumulated earnings and profits of the foreign investment company and the ratable share thereof for the period during which the taxpayer held such stock, all the gain from the sale or exchange of stock in such company shall be considered as gain from the sale or exchange of property which is not a capital asset.

“(4) **HOLDING PERIOD OF STOCK MUST BE MORE THAN 6 MONTHS.**—This section shall not apply with respect to the sale or exchange of stock where the holding period of such stock as of the date of such sale or exchange is 6 months or less.

“(b) **DEFINITION OF FOREIGN INVESTMENT COMPANY.**—For purposes of this section, the term ‘foreign investment company’ means any foreign corporation—

1 “(1) registered under the Investment Company
2 Act of 1940, as amended (15 U.S.C. 80a-1 to 80b-2),
3 either as a management company or as a unit invest-
4 ment trust, or

5 “(2) engaged (or holding itself out as being
6 engaged) primarily in the business of investing, rein-
7 vesting, or trading in securities (within the meaning of
8 section 3 (a) (1) of such Act) at a time when more
9 than 50 percent of the total combined voting power of
10 all classes of stock entitled to vote, or of the total value
11 of shares of all classes of stock, was held, directly or
12 indirectly (within the meaning of section 954 (a)), by
13 United States persons (as defined in section 7701
14 (a) (30)).

15 “(c) STOCK HAVING TRANSFERRED OR SUBSTITUTED
16 BASIS.—To the extent provided in regulations prescribed
17 by the Secretary or his delegate, stock in a foreign corpora-
18 tion, the basis of which (in the hands of the taxpayer selling
19 or exchanging such stock) is determined by reference to the
20 basis (in the hands of such taxpayer or any other person)
21 of stock in a foreign investment company, shall be treated
22 as stock of a foreign investment company and held by the
23 taxpayer throughout the holding period for such stock (deter-
24 mined under section 1223).

1 “(d) RULES RELATING TO ENTITIES HOLDING FOR-
2 EIGN INVESTMENT COMPANY STOCK.—To the extent pro-
3 vided in regulations prescribed by the Secretary or his
4 delegate—

5 “(1) trust certificates of a trust to which section
6 677 (relating to income for benefit of grantor) applies,
7 and

8 “(2) stock of a domestic corporation,
9 shall be treated as stock of a foreign investment company and
10 held by the taxpayer throughout the holding period for such
11 certificates or stock (determined under section 1223) in the
12 same proportion that the investment in stock in a foreign
13 investment company by the trust or domestic corporation
14 bears to the total assets of such trust or corporation.

15 “(e) RULES RELATING TO STOCK ACQUIRED FROM A
16 DECEDENT.—

17 “(1) BASIS.—In the case of stock of a foreign
18 investment company acquired by bequest, devise, or
19 inheritance (or by the decedent’s estate) from a dece-
20 dent dying after December 31, 1962, the basis deter-
21 mined under section 1014 shall be reduced (but not
22 below the adjusted basis of such stock in the hands of
23 the decedent immediately before his death) by the
24 amount of the decedent’s ratable share of the accumu-

1 lated earnings and profits of such company. Any
2 stock so acquired shall be treated as stock described in
3 subsection (c).

4 “(2) DEDUCTION FOR ESTATE TAX.—If stock to
5 which subsection (a) applies is acquired from a dece-
6 dent, the taxpayer shall, under regulations prescribed
7 by the Secretary or his delegate, be allowed (for the
8 taxable year of the sale or exchange) a deduction from
9 gross income equal to that portion of the decedent’s
10 estate tax deemed paid which is attributable to the excess
11 of (A) the value at which such stock was taken into
12 account for purposes of determining the value of the
13 decedent’s gross estate, over (B) the value at which
14 it would have been so taken into account if such value
15 had been reduced by the amount described in para-
16 graph (1).

17 “(f) INFORMATION WITH RESPECT TO CERTAIN
18 FOREIGN INVESTMENT.—Every United States person who,
19 on the last day of the taxable year of a foreign investment
20 company beginning after December 31, 1962, owns 5 per-
21 cent or more in value of the stock of such company shall
22 furnish with respect to such company such information as the
23 Secretary or his delegate shall by regulations prescribe.

24 “(g) CROSS REFERENCE.—

“For special rules relating to the earnings and profits
of foreign investment companies, see section 312(l).

1 **“SEC. 1247. ELECTION BY FOREIGN INVESTMENT COM-**
2 **PANIES TO DISTRIBUTE INCOME CUR-**
3 **RENTLY.**

4 “(a) ELECTION BY FOREIGN INVESTMENT COM-
5 PANY.—

6 “(1) IN GENERAL.—If a foreign investment com-
7 pany which is described in section 1246 (b) (1) elects
8 (in the manner provided in regulations prescribed by
9 the Secretary or his delegate) on or before December
10 31, 1962, with respect to each taxable year beginning
11 after December 31, 1962, to—

12 “(A) distribute to its shareholders 90 percent
13 or more of what its taxable income would be if it
14 were a domestic corporation;

15 “(B) designate in a written notice mailed to
16 its shareholders at any time before the expiration
17 of 30 days after the close of its taxable year the
18 pro rata amount of the excess (determined as if such
19 corporation were a domestic corporation) of the net
20 long-term capital gains over the net short-term
21 capital losses; and the portion thereof which is being
22 distributed; and

23 “(C) provide such information as the Secre-
24 tary or his delegate deems necessary to carry out the
25 purposes of this section,

1 then section 1246 shall not apply with respect to the
2 qualified shareholders of such company during any
3 taxable year to which such election applies.

4 “(2) SPECIAL RULES.—

5 “(A) COMPUTATION OF TAXABLE INCOME.—

6 For purposes of paragraph (1) (A), the taxable
7 income of the company shall be computed without
8 regard to—

9 “(i) the excess of capital gains over losses
10 referred to in paragraph (1) (B),

11 “(ii) section 172 (relating to net operating
12 losses), and

13 “(iii) any deduction provided by part VIII
14 of subchapter B (other than the deduction pro-
15 vided by section 248, relating to organizational
16 expenditures).

17 “(B) DISTRIBUTIONS AFTER THE CLOSE OF
18 THE TAXABLE YEAR.—For purposes of paragraph
19 (1) (A), a distribution made after the close of the
20 taxable year and on or before the 15th day of the
21 third month of the next taxable year shall be treated
22 as distributed during the taxable year to the extent
23 elected by the company (in accordance with regu-
24 lations prescribed by the Secretary or his delegate)
25 on or before the 15th day of such third month.

1 “(C) CARRYOVER OF CAPITAL LOSSES FROM
2 NONELECTION YEARS DENIED.—In computing the
3 excess of capital gains over losses referred to in
4 paragraph (1) (B), section 1212 shall not apply
5 to losses incurred in or with respect to taxable years
6 before the first taxable year to which the election
7 applies.

8 “(b) YEARS TO WHICH ELECTION APPLIES.—The
9 election of any foreign investment company under this sec-
10 tion shall terminate as of the close of the taxable year pre-
11 ceding its first taxable year in which any of the following
12 occurs:

13 “(1) the company fails to comply with the provi-
14 sions of subparagraph (A), (B), or (C) of subsection
15 (a) (1), unless it is shown that such failure is due to
16 reasonable cause and not due to willful neglect,

17 “(2) the company is a foreign personal holding
18 company, or

19 “(3) the company is not a foreign investment com-
20 pany which is described in section 1246 (b) (1).

21 “(c) QUALIFIED SHAREHOLDERS.—For purposes of
22 this section—

23 “(1) IN GENERAL.—The term ‘qualified share-
24 holder’ means any shareholder who is a United States

1 person, other than a shareholder described in paragraph
2 (2).

3 “(2) CERTAIN UNITED STATES PERSONS EX-
4 CLUDED FROM DEFINITION.—A United States person
5 shall not be treated as a qualified shareholder for the
6 taxable year if for such taxable year (or for any prior
7 taxable year) he did not include, in computing his long-
8 term capital gains in his return for such taxable year,
9 the amount designated by such company pursuant to
10 subsection (a) (1) (B) as his share of the undistributed
11 capital gains of such company for its taxable year end-
12 ing within or with such taxable year of the taxpayer.
13 The preceding sentence shall not apply with respect
14 to any failure by the taxpayer to treat an amount as
15 provided therein if the taxpayer shows that such failure
16 was due to reasonable cause and not due to willful
17 neglect.

18 “(d) ADJUSTMENTS.—Under regulations prescribed
19 by the Secretary or his delegate, proper adjustment shall be
20 made—

21 “(1) in the earnings and profits of the electing
22 foreign investment company, and

23 “(2) the adjusted basis of stock of such company
24 held by qualified shareholders,

1 to reflect the inclusion in gross income by such shareholders
2 of undistributed capital gains.

3 “(e) LOSS ON SALE OR EXCHANGE OF CERTAIN STOCK
4 HELD LESS THAN 6 MONTHS.—If—

5 “(1) under this section, any qualified shareholder
6 treats any amount designated under subsection (a) (1)
7 (B) with respect to a share of stock as long-term capital
8 gain, and

9 “(2) such share is held by the taxpayer for less
10 than 6 months,

11 then any loss on the sale or exchange of such share shall,
12 to the extent of the amount described in paragraph (1),
13 be treated as loss from the sale or exchange of a capital
14 asset held for more than 6 months.”

15 (2) The table of sections for such part IV is
16 amended by adding at the end thereof the following:

“Sec. 1246. Gain on foreign investment company.

“Sec. 1247. Election by foreign investment companies to
distribute income currently.”

17 (b) CONFORMING AMENDMENTS.—

18 (1) EARNINGS AND PROFITS OF FOREIGN IN-
19 VESTMENT COMPANIES.—Section 312 (relating to
20 effect on earnings and profits) is amended by adding
21 after subsection (k) the following new subsection:

1 “(1) EARNINGS AND PROFITS OF FOREIGN INVEST-
2 MENT COMPANIES.—

3 “(1) ALLOCATION WITHIN AFFILIATED GROUP.—

4 In the case of a sale or exchange of stock in a foreign
5 investment company (as defined in section 1246 (b))
6 by a United States person (as defined in section 7701
7 (a) (30)), if such company is a member of an affiliated
8 group, then the accumulated earnings and profits of all
9 members of such affiliated group shall be allocated, under
10 regulations prescribed by the Secretary or his delegate,
11 in such manner as is proper to carry out the purposes of
12 section 1246.

13 “(2) AFFILIATED GROUP DEFINED.—For purposes
14 of paragraphs (1) and (2) of this subsection, the term
15 ‘affiliated group’ has the meaning assigned to such term
16 by section 1504 (a) ; except that (A) ‘more than 50
17 percent’ shall be substituted for ‘80 percent or more’,
18 and (B) all corporations shall be treated as includible
19 corporations (without regard to the provisions of
20 section 1504 (b)).

21 “(3) PARTIAL LIQUIDATIONS AND REDEMP-
22 TIONS.—

23 “(A) IN GENERAL.—If a foreign investment
24 company (as defined in section 1246) distributes
25 amounts in partial liquidation or in a redemption to

1 which section 302 (a) or 303 applies, the part of
2 such distribution which is properly chargeable to
3 earnings and profits shall be an amount which is
4 not in excess of the ratable share of the earnings
5 and profits of the company accumulated after
6 February 28, 1913, attributable to the stock so
7 redeemed.

8 “(B) EFFECTIVE DATE.—Subparagraph (A)
9 shall apply only with respect to distributions made
10 after December 31, 1962.”

11 (2) SALE OR EXCHANGE OF INTEREST IN PART-
12 NERSHIP.—Section 751 (d) (2) (relating to inventory
13 items which have appreciated substantially in value) is
14 amended by striking out “and” at the end of subpara-
15 graph (B), and by striking out subparagraph (C) and
16 inserting in lieu thereof the following new subparagraphs:

17 “(C) any other property of the partnership
18 which, if sold or exchanged by the partnership,
19 would result in a gain taxable under subsection (a)
20 of section 1246 (relating to gain on foreign invest-
21 ment company stock), and

22 “(D) any other property held by the partner-
23 ship which, if held by the selling or distributee part-
24 ner, would be considered property of the type
25 described in subparagraph (A), (B), or (C).”

1 (3) **HOLDING PERIOD OF PROPERTY.**—Section
2 1223 (relating to holding period of property) is amend-
3 ed by redesignating paragraph (10) as paragraph (11)
4 and inserting after paragraph (9) the following para-
5 graph:

6 “(10) In determining the period for which the
7 taxpayer has held trust certificates of a trust to which
8 subsection (d) of section 1246 applies, or the period
9 for which the taxpayer has held stock in a corporation
10 to which subsection (d) of section 1246 applies, there
11 shall be included the period for which the trust or cor-
12 poration (as the case may be) held the stock of foreign
13 investment companies.”

14 (c) **EFFECTIVE DATE.**—The amendments made by
15 this section shall apply with respect to taxable years begin-
16 ning after December 31, 1962.

17 **SEC. 16. GAIN FROM CERTAIN SALES OR EXCHANGES OF**
18 **STOCK IN CERTAIN FOREIGN CORPORATIONS.**

19 (a) **TREATMENT OF GAIN FROM THE REDEMPTION,**
20 **CANCELLATION, OR SALE OF STOCK IN CERTAIN FOREIGN**
21 **CORPORATIONS.**—Part IV of subchapter P of chapter 1
22 (relating to special rules for determining capital gains and
23 losses) is amended by adding after section 1247 (as added
24 by section 15 of this Act) the following new section:

1 "SEC. 1248. GAIN FROM CERTAIN SALES OR EXCHANGES
2 OF STOCK IN CERTAIN FOREIGN CORPORA-
3 TIONS.

4 "(a) REDEMPTIONS AND LIQUIDATIONS.—If a foreign
5 corporation redeems its stock in an exchange to which sec-
6 tion 302 (a) applies, or if a foreign corporation cancels its
7 stock in a complete or partial liquidation in an exchange to
8 which section 331 applies, then the gain of a United States
9 person (as defined in section 7701 (a) (30)) from the ex-
10 change of such stock shall be included in the gross income
11 of such person as a dividend, to the extent of such person's
12 proportionate share of the earnings and profits of the foreign
13 corporation accumulated after February 28, 1913.

14 "(b) SALES AND OTHER EXCHANGES.—If a United
15 States person (as defined in section 7701 (a) (30)) sells or
16 exchanges stock in a foreign corporation, then the gain
17 recognized on the sale or exchange of such stock shall be
18 considered as gain from the sale or exchange of property
19 which is not a capital asset, to the extent of such person's
20 proportionate share of the earnings and profits of the foreign
21 corporation accumulated during the period the stock sold or
22 exchanged was held by such person.

1 “(c) LIMITATIONS.—

2 “(1) CONTROLLED FOREIGN CORPORATIONS.—
3 Subsections (a) and (b) shall apply only if the foreign
4 corporation the stock of which is sold or exchanged (A)
5 is a controlled foreign corporation (as defined in section
6 954) at the time of the sale or exchange, or (B) was
7 such a controlled foreign corporation at any time during
8 the 5-year period ending on the date of the sale or
9 exchange.

10 “(2) 10-PERCENT OWNERSHIP.—Subsections (a)
11 and (b) shall apply only to a United States person who
12 can be considered, by applying the rules of constructive
13 ownership of section 955(b), as being the owner,
14 directly or indirectly, of 10 percent or more of the total
15 combined voting power of all classes of stock entitled
16 to vote of the foreign corporation at the time of the sale
17 or exchange, or at any time during the 5-year period
18 ending on the date of the sale or exchange.

19 “(3) ELIMINATION FROM EARNINGS AND PROFITS
20 OF AMOUNTS INCLUDED IN GROSS INCOME UNDER
21 SECTION 951.—In determining the amount to be con-
22 sidered a dividend under subsection (a), or as gain from
23 the sale or exchange of property which is not a capital

1 asset under subsection (b), the United States person's
2 proportionate share of earnings and profits of the foreign
3 corporation shall be reduced by the amount previously
4 included in the gross income of such person under section
5 951, with respect to the stock sold or exchanged, but
6 only to the extent such amount did not result in an
7 exclusion from gross income under section 956.

8 “(4) REDEMPTIONS TO PAY DEATH TAXES.—Sub-
9 sections (a) and (b) shall not apply to distributions to
10 which section 303 (relating to distributions in re-
11 demption of stock to pay death taxes) applies.

12 “(5) ADDITIONAL CONSIDERATION IN CERTAIN
13 REORGANIZATIONS.—Subsection (b) shall not apply to
14 gain recognized on exchanges to which section 356 (re-
15 lating to receipt of additional consideration in certain
16 reorganizations) applies.

17 “(6) TREATMENT OF AMOUNTS WHICH ARE ORDI-
18 NARY INCOME, ETC., UNDER OTHER PROVISIONS.—Sub-
19 sections (a) and (b) shall not apply with respect to any
20 amount to the extent that such amount is, under any
21 other provision of this title, treated as—

22 “(A) a dividend,

1 “(B) gain from the sale of an asset which is
2 not a capital asset, or

3 “(C) gain from the sale of an asset held for not
4 more than 6 months.

5 “(d) TAXPAYER TO ESTABLISH EARNINGS AND
6 PROFITS.—Unless the taxpayer establishes the amount of
7 the earnings and profits of the foreign corporation to be taken
8 into account under subsections (a) and (b), all gain from
9 the sale or exchange shall be considered a dividend under
10 subsection (a), or as gain from the sale or exchange of
11 property which is not a capital asset under subsection (b),
12 whichever applies.”

13 (b) CLERICAL AMENDMENT.—The table of sections for
14 such part IV is amended by adding at the end thereof the
15 following:

“Sec. 1248. Gain from certain sales or exchanges of stock
in certain foreign corporations.”

16 (c) EFFECTIVE DATE.—The amendments made by this
17 section shall apply with respect to sales or exchanges oc-
18 ccurring after the date of the enactment of this Act.

1 **SEC. 17. TAX TREATMENT OF COOPERATIVES AND**
2 **PATRONS.**

3 (a) **IN GENERAL.**—Chapter 1 (relating to normal
4 taxes and surtaxes) is amended by adding at the end thereof
5 the following new subchapter:

6 **“Subchapter T—Cooperatives and Their Patrons**

“Part I. Tax treatment of cooperatives.

“Part II. Tax treatment by patrons of patronage dividends.

“Part III. Definitions; special rules.

7 **“PART I—TAX TREATMENT OF COOPERATIVES**

“Sec. 1381. Organizations to which part applies.

“Sec. 1382. Taxable income of cooperatives.

“Sec. 1383. Computation of tax where cooperative redeems
nonqualified written notices of allocation.

8 **“SEC. 1381. ORGANIZATIONS TO WHICH PART APPLIES.**

9 “(a) **IN GENERAL.**—This part shall apply to—

10 “(1) any organization exempt from tax under sec-
11 tion 521 (relating to exemption of farmers' cooperatives
12 from tax), and

13 “(2) any corporation operating on a cooperative
14 basis other than an organization—

15 “(A) which is exempt from tax under this
16 chapter,

1 “(B) which is subject to the provisions of—

2 “(i) part II of subchapter H (relating
3 to mutual savings banks, etc.), or

4 “(ii) subchapter L (relating to insurance
5 companies), or

6 “(C) which is engaged in furnishing electric
7 energy, or providing telephone service, to persons
8 in rural areas.

9 “(b) TAX ON CERTAIN FARMERS’ COOPERATIVES.—

10 An organization described in subsection (a) (1) shall be
11 subject to the taxes imposed by section 11 or 1201.

12 **“SEC. 1382. TAXABLE INCOME OF COOPERATIVES.**

13 “(a) GROSS INCOME.—Except as provided in subsec-
14 tion (b), the gross income of any organization to which this
15 part applies shall be determined without any adjustment
16 (as a reduction in gross receipts, an increase in cost of goods
17 sold, or otherwise) by reason of any allocation or distribution
18 to a patron out of the net earnings of such organization.

19 “(b) PATRONAGE DIVIDENDS.—In determining the
20 taxable income of an organization to which this part applies,
21 there shall not be taken into account amounts paid during
22 the payment period for the taxable year—

23 “(1) as patronage dividends (as defined in section
24 1388 (a)), to the extent paid in money, qualified writ-
25 ten notices of allocation (as defined in section 1388

(c)), or other property (except nonqualified written notices of allocation (as defined in section 1388 (d))) with respect to patronage occurring during such taxable year; or

“(2) in money or other property (except written notices of allocation) in redemption of a nonqualified written notice of allocation which was paid as a patronage dividend during the payment period for the taxable year during which the patronage occurred.

For purposes of this title, any amount not taken into account under the preceding sentence shall be treated in the same manner as an item of gross income and as a deduction therefrom.

“(c) DEDUCTION FOR NONPATRONAGE DISTRIBUTIONS, ETC.—In determining the taxable income of an organization described in section 1381 (a) (1), there shall be allowed as a deduction (in addition to other deductions allowable under this chapter) —

“(1) amounts paid during the taxable year as dividends on its capital stock; and

“(2) amounts paid during the payment period for the taxable year—

“(A) in money, qualified written notices of allocation, or other property (except nonqualified written notices of allocation) on a patronage basis

1 to patrons with respect to its earnings during such
2 taxable year which are derived from business done
3 for the United States or any of its agencies or from
4 sources other than patronage, or

5 “(B) in money or other property (except writ-
6 ten notices of allocation) in redemption of a non-
7 qualified written notice of allocation which was paid,
8 during the payment period for the taxable year dur-
9 ing which the earnings were derived, on a patron-
10 age basis to a patron with respect to earnings de-
11 rived from business or sources described in subpara-
12 graph (A).

13 “(d) PAYMENT PERIOD FOR EACH TAXABLE YEAR.—
14 For purposes of subsections (b) and (c) (2), the payment
15 period for any taxable year is the period beginning with the
16 first day of such taxable year and ending with the fifteenth
17 day of the ninth month following the close of such year.

18 “(e) PRODUCTS MARKETING UNDER POOLING AR-
19 RANGEMENTS.—For purposes of subsection (b), in the case
20 of a pooling arrangement for the marketing of products, the
21 patronage shall (to the extent provided in regulations pre-
22 scribed by the Secretary or his delegate) be treated as
23 patronage occurring during the taxable year in which the
24 pool closes.

25 “(f) TREATMENT OF EARNINGS RECEIVED AFTER

1 PATRONAGE OCCURRED.—If any portion of the earnings
2 from business done with or for patrons is includible in the
3 organization's gross income for a taxable year after the
4 taxable year during which the patronage occurred, then for
5 purposes of applying subsection (b) to such portion the
6 patronage shall, to the extent provided in regulations pre-
7 scribed by the Secretary or his delegate, be considered to
8 have occurred during the taxable year of the organization
9 during which such earnings are includible in gross income.

10 **“SEC. 1383. COMPUTATION OF TAX WHERE COOPERATIVE**
11 **REDEEMS NONQUALIFIED WRITTEN NO-**
12 **TICES OF ALLOCATION.**

13 “(a) GENERAL RULE.—If, under section 1382 (b) (2)
14 or (c) (2) (B), a deduction is allowable to an organization
15 for the taxable year for amounts paid in redemption of non-
16 qualified written notices of allocation, then the tax imposed
17 by this chapter on such organization for the taxable year
18 shall be the lesser of the following:

19 “(1) the tax for the taxable year computed with
20 such deduction; or

21 “(2) an amount equal to—

22 “(A) the tax for the taxable year computed
23 without such deduction, minus

24 “(B) the decrease in tax under this chapter
25 for any prior taxable year (or years) which would

1 result solely from treating such nonqualified written
2 notices of allocation as qualified written notices of
3 allocation.

4 “(b) SPECIAL RULES.—

5 “(1) If the decrease in tax ascertained under sub-
6 section (a) (2) (B) exceeds the tax for the taxable year
7 (computed without the deduction described in subsection
8 (a)) such excess shall be considered to be a payment
9 of tax on the last day prescribed by law for the payment
10 of tax for the taxable year, and shall be refunded or
11 credited in the same manner as if it were an overpay-
12 ment for such taxable year.

13 “(2) For purposes of determining the decrease in
14 tax under subsection (a) (2) (B), the stated dollar
15 amount of any nonqualified written notice of allocation
16 which is to be treated under such subsection as a quali-
17 fied written notice of allocation shall be the amount paid
18 in redemption of such written notice of allocation which
19 is allowable as a deduction under section 1382 (b) (2)
20 or (c) (2) (B) for the taxable year.

21 “(3) If the tax imposed by this chapter for the tax-
22 able year is the amount determined under subsection
23 (a) (2), then the deduction described in subsection (a)
24 shall not be taken into account for any purpose of this
25 subtitle other than for purposes of this section.

1 **"PART II—TAX TREATMENT BY PATRONS OF PA-**
2 **TRONAGE DIVIDENDS**

"Sec. 1385. Amounts includible in patron's gross income.

3 **"SEC. 1385. AMOUNTS INCLUDIBLE IN PATRON'S GROSS**
4 **INCOME.**

5 "(a) **GENERAL RULE.**—Except as otherwise provided
6 in subsection (b), each person shall include in gross
7 income—

8 "(1) the amount of any patronage dividend which
9 is paid in money, a qualified written notice of allocation,
10 or other property (except a nonqualified written notice
11 of allocation), and which is received by him during the
12 taxable year from an organization described in section
13 1381 (a), and

14 "(2) any amount, described in section 1382 (c) (2)
15 (A) (relating to certain nonpatronage distributions by
16 tax-exempt farmers' cooperatives), which is paid in
17 money, a qualified written notice of allocation, or other
18 property (except a nonqualified written notice of alloca-
19 tion), and which is received by him during the taxable
20 year from an organization described in section 1381 (a)
21 (1).

22 "(b) **EXCLUSION FROM GROSS INCOME.**—Under regu-
23 lations prescribed by the Secretary or his delegate, the

1 amount of any patronage dividend, and any amount re-
2 ceived on the redemption, sale, or other disposition of a non-
3 qualified written notice of allocation which was paid as a
4 patronage dividend, shall not be included in gross income to
5 the extent that such amount—

6 “(1) is properly taken into account as an adjust-
7 ment to basis of property, or

8 “(2) is attributable to personal, living, or family
9 items.

10 “(c) TREATMENT OF CERTAIN NONQUALIFIED WRIT-
11 TEN NOTICES OF ALLOCATION.—

12 “(1) APPLICATION OF SUBSECTION.—This sub-
13 section shall apply to any nonqualified written notice of
14 allocation which—

15 “(A) was paid as a patronage dividend, or

16 “(B) was paid by an organization described in
17 section 1381 (a) (1) on a patronage basis with re-
18 spect to earnings derived from business or sources
19 described in section 1382 (c) (2) (A) .

20 “(2) BASIS; AMOUNT OF GAIN.—In the case of
21 any nonqualified written notice of allocation to which
22 this subsection applies, for purposes of this chapter—

23 “(A) the basis of such written notice of alloca-
24 tion in the hands of the patron to whom such written
25 notice of allocation was paid shall be zero,

“(B) the basis of such written notice of allocation which was acquired from a decedent shall be its basis in the hands of the decedent, and

“(C) gain on the redemption, sale, or other disposition of such written notice of allocation by any person shall, to the extent that the stated dollar amount of such written notice of allocation exceeds its basis, be considered as gain from the sale or exchange of property which is not a capital asset.

“PART III—DEFINITIONS; SPECIAL RULES

“Sec. 1388. Definitions; special rules.

“SEC. 1388. DEFINITIONS; SPECIAL RULES.

“(a) PATRONAGE DIVIDEND.—For purposes of this subchapter, the term ‘patronage dividend’ means an amount paid to a patron by an organization to which part I of this subchapter applies—

“(1) on the basis of quantity or value of business done with or for such patron,

“(2) under an obligation of such organization to pay such amount, which obligation existed before the organization received the amount so paid, and

“(3) which is determined by reference to the net earnings of the organization from business done with or for its patrons.

1 Such term does not include any amount paid to a patron to
2 the extent that (A) such amount is out of earnings other
3 than from business done with or for patrons, or (B)
4 such amount is out of earnings from business done with or
5 for other patrons to whom no amounts are paid, or to whom
6 smaller amounts are paid, with respect to substantially
7 identical transactions.

8 “(b) WRITTEN NOTICE OF ALLOCATION.—For pur-
9 poses of this subchapter, the term ‘written notice of alloca-
10 tion’ means any capital stock, revolving fund certificate,
11 retain certificate, certificate of indebtedness, letter of advice,
12 or other written notice, which discloses to the recipient the
13 stated dollar amount allocated to him by the organization
14 and the portion thereof, if any, which constitutes a patronage
15 dividend.

16 “(c) QUALIFIED WRITTEN NOTICE OF ALLOCATION.—

17 “(1) DEFINED.—For purposes of this subchapter,
18 the term ‘qualified written notice of allocation’ means—

19 “(A) a written notice of allocation which may
20 be redeemed in cash at its stated dollar amount at
21 any time within a period beginning on the date such
22 written notice of allocation is paid and ending not
23 earlier than 90 days from such date, but only if the
24 distributee receives written notice of the right of

1 redemption at the time he receives such written no-
2 tice of allocation; and

3 “(B) a written notice of allocation which the
4 distributee has consented, in the manner provided
5 in paragraph (2), to take into account at its stated
6 dollar amount as provided in section 1385 (a).

7 “(2) MANNER OF OBTAINING CONSENT.—A dis-
8 tributee shall consent to take a written notice of alloca-
9 tion into account as provided in paragraph (1) (B)
10 only by—

11 “(A) making such consent in writing, or

12 “(B) obtaining or retaining membership in the
13 organization after—

14 “(i) such organization has adopted (after
15 the date of the enactment of the Revenue Act
16 of 1962) a bylaw providing that membership
17 in the organization constitutes such consent, and

18 “(ii) he has received a written notifica-
19 tion and copy of such bylaw.

20 “(3) PERIOD FOR WHICH CONSENT IS EFFEC-
21 TIVE.—

22 “(A) GENERAL RULE.—Except as provided in
23 subparagraph (B) —

24 “(i) a consent described in paragraph

1 (2) (A) shall be a consent with respect to all
2 patronage of the distributee with the organiza-
3 tion occurring (determined with the application
4 of section 1382 (e)) during the taxable year of
5 the organization during which such consent is
6 made and all subsequent taxable years of the
7 organization; and

8 “(ii) a consent described in paragraph
9 (2) (B) shall be a consent with respect to all
10 patronage of the distributee with the organiza-
11 tion occurring (determined without the applica-
12 tion of section 1382 (e)) after he received the
13 notification and copy described in paragraph
14 (2) (B) (ii) .

15 “(B) REVOCATION, ETC.—

16 “(i) Any consent described in paragraph
17 (2) (A) may be revoked (in writing) by the
18 distributee at any time. Any such revocation
19 shall be effective with respect to patronage
20 occurring on or after the first day of the first
21 taxable year of the organization beginning after
22 the revocation is filed with such organization;
23 except that in the case of a pooling arrangement
24 described in section 1382 (e) , a revocation made
25 by a distributee shall not be effective as to any

pool with respect to which the distributee has been a patron before such revocation.

“(ii) Any consent described in paragraph (2) (B) shall not be effective with respect to any patronage occurring (determined without the application of section 1382 (e)) after the distributee ceases to be a member of the organization or after the bylaws of the organization cease to contain the provision described in paragraph (2) (B) (i) .

“(d) NONQUALIFIED WRITTEN NOTICE OF ALLOCATION.—For purposes of this subchapter, the term ‘nonqualified written notice of allocation’ means a written notice of allocation which is not described in subsection (c) .

“(e) DETERMINATION OF AMOUNT PAID OR RECEIVED.—For purposes of this subchapter, in determining amounts paid or received—

“(1) property (other than a written notice of allocation) shall be taken into account at its fair market value, and

“(2) a qualified written notice of allocation shall be taken into account at its stated dollar amount.”

(b) TECHNICAL AMENDMENTS.—

(1) Section 521 (a) (relating to exemption of farm-

1 ers' cooperatives from tax) is amended by striking out
 2 "section 522" each place it appears therein and inserting
 3 in lieu thereof "part I of subchapter T (sec. 1381 and
 4 following)".

5 (2) Section 522 (relating to tax on farmers' coop-
 6 eratives) is hereby repealed.

7 (3) Section 6044 (relating to returns regarding
 8 patronage dividends) is amended to read as follows:

9 **"SEC. 6044. RETURNS REGARDING PATRONAGE DIVI-**
 10 **DENDS.**

11 "Any organization to which part I of subchapter T of
 12 chapter 1 (relating to tax treatment of cooperatives) ap-
 13 plies which pays amounts described in section 1382 (b), or
 14 (in the case of an organization described in section 1381
 15 (a) (1)) amounts described in section 1382 (c) (2), shall,
 16 when required by regulations of the Secretary or his delegate,
 17 make a return showing—

18 "(1) the name and address of each patron to whom
 19 it has made such payments during the calendar year; and

20 "(2) the amount of such payments to each patron."

21 (4) Section 6072 (d) (relating to time for filing
 22 income tax returns of exempt cooperative associations)
 23 is amended to read as follows:

24 "(d) RETURNS OF COOPERATIVE ASSOCIATIONS.—In
 25 the case of an income tax return of—

1 “(1) an exempt cooperative association described
2 in section 1381 (a) (1), or

3 “(2) an organization described in section 1381
4 (a) (2) which is under an obligation to pay patronage
5 dividends (as defined in section 1388 (a)) in an
6 amount equal to at least 50 percent of its net earnings
7 from business done with or for its patrons, or which
8 paid patronage dividends in such an amount out of the
9 net earnings from business done with or for patrons dur-
10 ing the most recent taxable year for which it had such
11 net earnings,

12 a return made on the basis of a calendar year shall be filed
13 on or before the 15th day of September following the close
14 of the calendar year, and a return made on the basis of a
15 fiscal year shall be filed on or before the 15th day of the 9th
16 month following the close of the fiscal year.”

17 (5) The table of subchapters for chapter 1 is
18 amended by adding at the end thereof the following:

 “SUBCHAPTER T. Cooperatives and their patrons.”

19 (6) The table of sections for part III of subchapter
20 F of chapter 1 is amended by striking out the last line
21 thereof.

22 (c) EFFECTIVE DATES.—

23 (1) FOR THE COOPERATIVES.—Except as provided

1 in paragraph (3), the amendments made by subsections
2 (a) and (b) shall apply to taxable years of organiza-
3 tions described in section 1381 (a) of the Internal Reve-
4 nue Code of 1954 (as added by subsection (a)) begin-
5 ning after December 31, 1962.

6 (2) FOR THE PATRONS.—Except as provided in
7 paragraph (3), section 1385 of the Internal Revenue
8 Code of 1954 (as added by subsection (a)) shall
9 apply with respect to any amount received from any
10 organization described in section 1381 (a) of such Code,
11 to the extent that such amount is paid by such organiza-
12 tion in a taxable year of such organization beginning
13 after December 31, 1962.

14 (3) APPLICATION OF EXISTING LAW.—In the case
15 of any money, written notice of allocation, or other prop-
16 erty paid by any organization described in section
17 1381 (a) —

18 (A) before the first day of the first taxable
19 year of such organization beginning after December
20 31, 1962, or

21 (B) on or after such first day with respect to
22 patronage occurring before such first day,
23 the tax treatment of such money, written notice of allo-
24 cation, or other property (including the tax treatment of
25 gain or loss on the redemption, sale, or other disposition

of such written notice of allocation) by any person shall be made under the Internal Revenue Code of 1954 without regard to subchapter T of chapter 1 of such Code.

SEC. 18. INCLUSION OF FOREIGN REAL PROPERTY IN GROSS ESTATE.

(a) AMENDMENTS TO INCLUDE FOREIGN REAL PROPERTY.—

(1) Section 2031 (a) (relating to definition of gross estate) is amended by striking out “, except real property situated outside of the United States”.

(2) The following provisions of chapter 11 (imposing an estate tax) are amended by striking out “(except real property situated outside of the United States)”:

(A) section 2033 (relating to property in which the decedent had an interest),

(B) section 2034 (relating to dower or curtesy interests),

(C) section 2035 (a) (relating to transactions in contemplation of death),

(D) section 2036 (a) (relating to transfers with retained life estate),

(E) section 2037 (a) (relating to transfers taking effect at death),

(F) section 2038 (a) (relating to revocable transfers),

1 (G) section 2040 (relating to joint interests),
2 and

3 (H) section 2041 (a) (relating to powers of
4 appointment).

5 (b) EFFECTIVE DATE.—

6 (1) Except as provided in paragraph (2), the
7 amendments made by subsection (a) shall apply to the
8 estates of decedents dying after the date of the enactment
9 of this Act.

10 (2) In the case of a decedent dying after the date
11 of the enactment of this Act and before July 1, 1964,
12 the value of real property situated outside of the United
13 States shall not be included in the gross estate (as defined
14 in section 2031 (a)) of the decedent—

15 (A) under section 2033, 2034, 2035 (a),
16 2036 (a), 2037 (a), or 2038 (a) to the extent the
17 real property, or the decedent's interest in it, was
18 acquired by the decedent before February 1, 1962;

19 (B) under section 2040 to the extent such
20 property or interest was acquired by the decedent
21 before February 1, 1962, or was held by the de-
22 cent and the survivor in a joint tenancy or tenancy
23 by the entirety before February 1, 1962; or

24 (C) under section 2041 (a) to the extent that
25 before February 1, 1962, such property or interest

1 was subject to a general power of appointment (as
2 defined in section 2041) possessed by the decedent.

3 In the case of real property, or an interest therein, sit-
4 uated outside of the United States (including a general
5 power of appointment in respect of such property or
6 interest, and including property held by the decedent
7 and the survivor in a joint tenancy or tenancy by the
8 entirety) which was acquired by the decedent after
9 January 31, 1962, by gift within the meaning of sec-
10 tion 2511, or from a prior decedent by devise or inheri-
11 tance, or by reason of death, form of ownership, or other
12 conditions (including the exercise or nonexercise of a
13 power of appointment), for purposes of this paragraph
14 such property or interest therein shall be deemed to have
15 been acquired by the decedent before February 1, 1962,
16 if before that date the donor or prior decedent had
17 acquired the property or his interest therein or had
18 possessed a power of appointment in respect of the prop-
19 erty or interest.

20 **SEC. 19. WITHHOLDING OF INCOME TAX AT SOURCE ON**
21 **INTEREST, DIVIDENDS, AND PATRONAGE DIVI-**
22 **DENDS.**

23 (a) IN GENERAL.—

24 (1) AMENDMENT OF SUBTITLE C.—Subtitle C (re-
25 lating to employment taxes and collection of income tax

1 at source) is amended by redesignating chapter 25 as
 2 chapter 26 and by inserting after chapter 24 the follow-
 3 ing new chapter:

4 **“CHAPTER 25—COLLECTION OF INCOME TAX**
 5 **AT SOURCE ON INTEREST, DIVIDENDS,**
 6 **AND PATRONAGE DIVIDENDS**

“SUBCHAPTER A. Interest.

“SUBCHAPTER B. Dividends.

“SUBCHAPTER C. Patronage dividends.

“SUBCHAPTER D. General provisions.

7 **“Subchapter A—Interest**

“Sec. 3451. Income tax collected at source on interest.

“Sec. 3452. Interest defined.

8 **“SEC. 3451. INCOME TAX COLLECTED AT SOURCE ON**
 9 **INTEREST.**

10 “(a) REQUIREMENT OF WITHHOLDING.—Except as
 11 otherwise provided in this chapter, every person who pays
 12 interest shall deduct and withhold on such interest a tax
 13 equal to 20 percent of the amount thereof.

14 “(b) PAYEE UNKNOWN.—If the withholding agent is
 15 unable to determine the person to whom the interest is pay-
 16 able, the tax under this section shall be deducted and with-
 17 held at the time payment of the interest would be made if
 18 such person were known.

1 “(c) CROSS REFERENCES.—

 “(1) For credit, against income tax of the recipient of the income, of amounts deducted and withheld under this section, see section 39.

 “(2) For special rules as to credit or refund of such amounts, see sections 3484, 3485, 3486, 3487, and 3505.

 “(3) For exemption from requirement of deducting and withholding on certain interest paid to certain persons, see section 3483.

2 “SEC. 3452. INTEREST DEFINED.

3 “(a) GENERAL RULE.—For purposes of this chapter,
4 the term ‘interest’ means—

5 “(1) interest on evidences of indebtedness (includ-
6 ing bonds, debentures, notes, and certificates) issued by
7 a corporation with interest coupons or in registered
8 form, and, to the extent provided in regulations pre-
9 scribed by the Secretary or his delegate, interest on
10 other evidences of indebtedness issued by a corporation
11 of a type offered by corporations to the public;

12 “(2) interest on deposits with persons carrying on
13 the banking business;

14 “(3) amounts (whether or not designated as in-
15 terest) paid by a mutual savings bank, savings and loan
16 association, building and loan association, cooperative
17 bank, homestead association, credit union, or similar

1 organization, in respect of deposits, investment certifi-
2 cates, or withdrawable or repurchasable shares;

3 “(4) interest on amounts held by an insurance com-
4 pany under an agreement to pay interest thereon;

5 “(5) interest on deposits with stockbrokers;

6 “(6) interest on obligations of the United States;

7 and

8 “(7) in the case of a non-interest-bearing obliga-
9 tion of the United States—

10 “(A) issued on a discount basis, and

11 “(B) having a maturity date more than one
12 year from the date of issue,

13 the amount by which the amount paid on surrender or
14 redemption exceeds the issue price.

15 “(b) EXCEPTIONS.—For purposes of this chapter, the
16 term ‘interest’ does not include—

17 “(1) interest on obligations described in section
18 103 (a) (1) or (3) (relating to interest on certain
19 governmental obligations) ;

20 “(2) any amount paid by—

21 “(A) a foreign government or international
22 organization,

23 “(B) a foreign corporation not engaged in
24 trade or business within the United States,

25 “(C) a nonresident alien individual not en-

1 gaged in trade or business within the United States,
2 or

3 “(D) a partnership not engaged in trade or
4 business within the United States and composed in
5 whole or in part of nonresident aliens;

6 “(3) interest on deposits with persons carrying on
7 the banking business paid to a person described in para-
8 graph (2) (B), (C), or (D) ;

9 “(4) any amount paid by one corporation to an-
10 other corporation, if both corporations are members of
11 the same affiliated group which filed a consolidated re-
12 turn for the preceding taxable year of the affiliated
13 group;

14 “(5) interest subject to withholding under subchap-
15 ter A of chapter 3 (sec. 1441 and following, relating to
16 withholding of tax on nonresident aliens and foreign cor-
17 porations) by the person paying such interest, or which
18 would be so subject to withholding by such person, but
19 for the fact that it is not treated as income from sources
20 within the United States;

21 “(6) any amount on which the withholding agent
22 is required to deduct and withhold a tax under section
23 1451 (relating to tax-free covenant bonds), or would be
24 so required but for section 1451 (d) (relating to benefit
25 of personal exemptions) ;

1 “(7) to the extent provided in regulations pre-
 2 scribed by the Secretary or his delegate, any amount
 3 payable with respect to deposits in school savings
 4 accounts; and

5 “(8) any amount described in subsection (a) (2),
 6 (3), or (7) paid to a State or a foreign government
 7 or international organization (other than any amount
 8 described in subsection (a) (3) paid in respect of a
 9 transferable certificate or share).

10 “(c) EXEMPTION FOR UNITED STATES.—The Secre-
 11 tary may authorize exemption from the tax imposed by sec-
 12 tion 3451 for any amount paid by the United States or
 13 any wholly owned agency or instrumentality thereof to the
 14 United States or any wholly owned agency or instrumental-
 15 ity thereof if the Secretary determines that the imposition
 16 of the tax with respect to such amount will cause a burden
 17 or expense which can be avoided by granting the tax
 18 exemption.

19 “Subchapter B—Dividends

“Sec. 3461. Income tax collected at source on dividends.

“Sec. 3462. Dividend defined.

20 “SEC. 3461. INCOME TAX COLLECTED AT SOURCE ON 21 DIVIDENDS.

22 “(a) REQUIREMENT OF WITHHOLDING.—Except as
 23 otherwise provided in this chapter, every person who pays

1 a dividend shall deduct and withhold on such dividend a tax
2 equal to 20 percent of the amount thereof.

3 “(b) PAYEE UNKNOWN.—If the withholding agent is
4 unable to determine the person to whom the dividend is
5 payable, the tax under this section shall be deducted and
6 withheld at the time payment of the dividend would be
7 made if such person were known.

8 “(c) AMOUNT OF DIVIDEND UNKNOWN.—If the with-
9 holding agent is unable to determine the portion of a dis-
10 tribution which is a dividend, the tax under this section
11 shall be computed on the entire amount of the distribution.

12 “(d) CROSS REFERENCES.—

“(1) For credit, against income tax of the recipient of the income, of amounts deducted and withheld under this section, see section 39.

“(2) For special rules as to credit or refund of such amounts, see sections 3484, 3485, 3486, 3487, and 3505.

“(3) For exemption from requirement of deducting and withholding on dividends paid to certain individuals, see section 3483.

13 “SEC. 3462. DIVIDEND DEFINED.

14 “(a) GENERAL RULE.—For purposes of this chapter,
15 the term ‘dividend’ means—

16 “(1) any distribution by a corporation which is a
17 dividend (as defined in section 316) ; and

18 “(2) any payment made by a stockbroker to any
19 person as a substitute for a dividend (as so defined).

20 “(b) EXCEPTIONS.—For purposes of this chapter, the
21 term ‘dividend’ does not include—

1 “(1) any amount paid in the stock, or rights to
2 acquire the stock, of the distributing corporation if the
3 distribution is not includible in gross income of the re-
4 cipient under the provisions of section 305 (relating to
5 distributions of stock and stock rights) ;

6 “(2) any distribution to the extent that, under
7 chapter 1—

8 “(A) the amount thereof is treated by the re-
9 cipient as an amount received on the sale or ex-
10 change of property, or

11 “(B) gain or loss to the recipient is not recog-
12 nized;

13 “(3) any amount which is includible in gross in-
14 come as a taxable dividend by reason of the provisions
15 of section 302 (relating to redemptions of stock), 306
16 (relating to dispositions of certain stock), 356 (relating
17 to receipt of additional consideration in connection with
18 certain reorganizations), or 1081 (e) (2) (relating to
19 certain distributions pursuant to order of the Securities
20 and Exchange Commission) ;

21 “(4) any amount paid by one corporation to an-
22 other corporation, if both corporations are members of
23 the same affiliated group which filed a consolidated re-
24 turn for the preceding taxable year of the affiliated
25 group;

1 “(5) an amount which—

2 “(A) is subject to withholding under subchap-
3 ter A of chapter 3 (sec. 1441 and following, relating
4 to withholding of tax on nonresident aliens and for-
5 eign corporations) by the person paying such
6 amount, or

7 “(B) would be subject to withholding under
8 such subchapter A by the person paying such
9 amount but for—

10 “(i) the fact that it is attributable to in-
11 come from sources outside the United States, or

12 “(ii) the fact that the payor thereof is
13 excepted from the application of section
14 1441 (a) by the provisions of section 1441 (c) ;

15 “(6) any amount paid by a foreign corporation not
16 engaged in trade or business within the United States;

17 “(7) any amount described in section 1373 (relat-
18 ing to undistributed taxable income of electing small
19 business corporations) ; and

20 “(8) amounts paid pursuant to the terms of a
21 lease entered into before January 1, 1954, if under such
22 lease the shareholders of the lessor corporation are en-
23 titled to such amounts without deduction for any tax
24 which any law of the United States might require to be
25 deducted and withheld on the payment of dividends.

1 **“Subchapter C—Patronage Dividends**

“Sec. 3471. Income tax collected at source on patronage dividends.

“Sec. 3472. Amounts subject to withholding.

2 **“SEC. 3471. INCOME TAX COLLECTED AT SOURCE ON** 3 **PATRONAGE DIVIDENDS.**

4 “(a) REQUIREMENT OF WITHHOLDING.—Except as
 5 otherwise provided in this chapter, every cooperative to
 6 which part I of subchapter T of chapter 1 applies which pays
 7 an amount described in section 3472 shall deduct and with-
 8 hold on such amount a tax equal to 20 percent of such
 9 amount.

10 “(b) PAYEE UNKNOWN.—If the withholding agent is
 11 unable to determine the person to whom the amount is pay-
 12 able, the tax under this section shall be deducted and with-
 13 held at the time payment of the amount would be made if
 14 such person were known.

15 “(c) CROSS REFERENCES.—

“ (1) For credit, against income tax of the recipient of the income, of amounts deducted and withheld under this section, see section 39.

“ (2) For special rules as to credit or refund of such amounts, see sections 3484, 3485, 3486, 3487, and 3505.

“ (3) For exemption from requirement of deducting and withholding on amounts paid to certain individuals, see section 3483.

16 **“SEC. 3472. AMOUNTS SUBJECT TO WITHHOLDING.**

17 “(a) GENERAL RULE.—Except as otherwise provided
 18 in this section or section 3483, the amounts subject to deduc-
 19 tion and withholding under section 3471 are—

1 “(1) the amount of any patronage dividend (as
2 defined in section 1388 (a)) which is paid in money,
3 qualified written notices of allocation (as defined in sec-
4 tion 1388 (c)), or other property (except nonqualified
5 written notices of allocation as defined in section
6 1388 (d)), and

7 “(2) any amount, described in section 1382 (c) (2)
8 (A) (relating to certain nonpatronage distributions),
9 which is paid in money, qualified written notices of al-
10 location, or other property (except nonqualified written
11 notices of allocation) by an organization exempt from
12 tax under section 521 (relating to exemption of farm-
13 ers’ cooperatives from tax).

14 “(b) EXCEPTIONS.—The provisions of section 3471
15 shall not apply to—

16 “(1) any amount paid by one corporation to an-
17 other corporation, if both corporations are members of
18 the same affiliated group which filed a consolidated re-
19 turn for the preceding taxable year of the affiliated
20 group;

21 “(2) an amount which—

22 “(A) is subject to withholding under sub-
23 chapter A of chapter 3 (sec. 1441 and following,
24 relating to withholding of tax on nonresident aliens

1 and foreign corporations) by the person paying such
2 amount, or

3 “(B) would be subject to withholding under
4 such subchapter A by the person paying such
5 amount but for the fact that it is attributable to
6 income from sources outside the United States; and

7 “(3) any amount paid by a foreign corporation
8 not engaged in trade or business within the United
9 States.

10 “(c) EXEMPTION FOR CERTAIN CONSUMER COOPERA-
11 TIVES.—A cooperative which the Secretary or his delegate
12 determines is primarily engaged in selling at retail goods
13 or services of a type that are generally for personal, living,
14 or family use shall, upon application to the Secretary or his
15 delegate, be granted exemption from the tax imposed by
16 section 3471. Application for exemption under this sub-
17 section shall be made in accordance with regulations pre-
18 scribed by the Secretary or his delegate.

19 “(d) DETERMINATION OF AMOUNT PAID.—For pur-
20 poses of this subchapter, in determining amounts paid—

21 “(1) property (other than a written notice of
22 allocation) shall be taken into account at its fair market
23 value, and

24 “(2) a qualified written notice of allocation shall
25 be taken into account at its stated dollar amount.

1 **“Subchapter D—General Provisions**

“Sec. 3481. Liability for return and payment of withheld tax.

“Sec. 3482. Return and payment by United States.

“Sec. 3483. Exemption certificates.

“Sec. 3484. Refund of tax to individuals.

“Sec. 3485. Refund of tax to States, tax-exempt organizations, etc.

“Sec. 3486. Refund of tax to corporation.

“Sec. 3487. Credit for tax withheld on corporation.

“Sec. 3488. Obligation sold between interest-payment dates.

“Sec. 3489. Presumption.

“Sec. 3490. Definitions.

2 **“SEC. 3481. LIABILITY FOR RETURN AND PAYMENT OF** 3 **WITHHELD TAX.**

4 “(a) **GENERAL RULE.**—Every person required to de-
5 duct and withhold any tax under this chapter shall, on or be-
6 fore the last day of the first month following the close of each
7 quarter of his taxable year, make a return of the tax required
8 to be deducted and withheld during such quarter and pay the
9 tax to the officer designated in section 6151. The withhold-
10 ing agent shall be liable for the payment of the taxes required
11 to be deducted and withheld under this chapter, and shall not
12 otherwise be liable to any person for the amount of any
13 such payment.

14 “(b) **TAX PAID BY RECIPIENT.**—If the withholding
15 agent, in violation of the provisions of this chapter, fails to
16 deduct and withhold any tax under this chapter, and there-
17 after the tax against which such tax may be credited is
18 paid, the tax so required to be deducted and withheld shall

1 not be collected from the withholding agent; but this sub-
2 section shall in no case relieve the withholding agent from
3 liability for any penalties or additions to the tax otherwise
4 applicable in respect of such failure to deduct and withhold.

5 “(c) CROSS REFERENCE.—

“For limitation on the use of Government depositaries
in the collection of taxes deducted and withheld under
this chapter, see the last sentence of section 6302(c).

6 “SEC. 3482. RETURN AND PAYMENT BY UNITED STATES.

7 “If the withholding agent is the United States the re-
8 turn of the tax deducted and withheld under this chapter may
9 be made by an officer or employee of the United States
10 having control of the payment of the amount subject to
11 withholding, or appropriately designated for that purpose.

12 “SEC. 3483. EXEMPTION CERTIFICATES.

13 “(a) GENERAL RULES.—

14 “(1) INDIVIDUALS UNDER AGE 18.—Any indi-
15 vidual may file with any withholding agent an exemp-
16 tion certificate on which he certifies the date of his
17 birth. If such a certificate is filed, all amounts pay-
18 able by such withholding agent to such individual, on
19 and after the effective date for such certificate and
20 before the beginning of the calendar year during which
21 the certificate indicates that he will attain age 18, shall
22 be exempt from the requirement of deducting and with-
23 holding under this chapter.

1 “(2) INDIVIDUALS OVER AGE 17.—Any individual
2 may file with any withholding agent an exemption
3 certificate on which he certifies—

4 “(A) that he will have attained age 18 before
5 the close of the calendar year for which such certifi-
6 cate is filed, and

7 “(B) that he reasonably believes that he will
8 not (after the application of the credits against tax
9 provided by part IV of subchapter A of chapter 1,
10 other than the credits under sections 31 and 39) be
11 liable for the payment of any tax under chapter 1 for
12 each of his taxable years any portion of which is
13 included in the period for which such certificate
14 will be in effect.

15 If such a certificate is filed, all amounts payable by such
16 withholding agent to such individual during the period
17 such certificate is in effect shall be exempt from the
18 requirement of deducting and withholding under this
19 chapter. Except as may otherwise be provided in regu-
20 lations prescribed by the Secretary or his delegate, an
21 exemption certificate filed by an individual described in
22 this paragraph shall remain in effect only for the period
23 beginning on the effective date of such certificate and

1 ending at the close of the calendar year in which such
2 period begins.

3 “(3) TAX-EXEMPT ORGANIZATIONS.—

4 “(A) Any organization (other than a coopera-
5 tive described in section 521) which is exempt from
6 the tax imposed by chapter 1 may file with any
7 withholding agent who pays amounts described in
8 section 3452 (a) (2), (3), or (7) an exemption
9 certificate on which it certifies that it is such an
10 organization. If such a certificate is filed, all
11 amounts described in section 3452 (a) (2),
12 (3), and (7) payable by such withholding agent
13 to such organization on and after the effective date
14 for such certificate shall (except as provided in sub-
15 paragraph (B)) be exempt from the requirement
16 of deducting and withholding under this chapter.

17 “(B) An exemption certificate filed by an
18 organization under subparagraph (A) shall cease
19 to be effective on the thirtieth day after the day on
20 which the withholding agent, with whom such cer-
21 tificate was filed, is notified by either the organiza-
22 tion or the Secretary or his delegate that the
23 organization is no longer exempt from the tax im-
24 posed by chapter 1. If an organization ceases to be
25 exempt from such tax, it shall, within the time speci-

1 fied in regulations prescribed by the Secretary or his
2 delegate, so notify each withholding agent with
3 whom it has an exemption certificate in effect.

4 “(b) EXCEPTIONS AND SPECIAL RULES.—

5 “(1) CERTAIN EXCEPTIONS.—This section shall
6 not apply to any amount—

7 “(A) described in section 3452 (a) (1) (re-
8 lating to interest on evidences of indebtedness),

9 “(B) described in section 3452 (a) (3) paid
10 in respect of a transferable certificate or share, or

11 “(C) described in section 3452 (a) (6) (relat-
12 ing to interest on obligations of the United States).

13 “(2) SERIES E BONDS, ETC.—In the case of trans-
14 actions involving the redemption of one or more obliga-
15 tions described in section 3452 (a) (7) (relating to cer-
16 tain obligations of the United States issued on a discount
17 basis), a separate certificate shall be filed with respect
18 to each such transaction.

19 “(3) NOMINEES, CUSTODIANS, AND JOINT OWNER-
20 SHIPS.—Under regulations prescribed by the Secretary
21 or his delegate, the exemption provided by subsection
22 (a) may be extended, in a manner consistent with the
23 other provisions of this section, to—

24 “(A) amounts (other than amounts described

1 in section 3462 (a), relating to dividends) paid
2 through nominees;

3 “(B) amounts paid to custodians; and

4 “(C) amounts paid jointly to 2 or more
5 individuals.

6 “(4) EFFECTIVE DATE OF CERTIFICATE.—Any
7 exemption certificate under this section shall take effect
8 on such day as is specified in accordance with regula-
9 tions prescribed by the Secretary or his delegate.

10 “(5) FORM AND CONTENTS OF CERTIFICATE AND
11 NOTICE.—Any exemption certificate under this section,
12 and any notice under subsection (a) (3) (B), shall be
13 in such form and contain such information as the Secre-
14 tary or his delegate may by regulations prescribe.

15 “(c) CROSS REFERENCE.—

“For penalty for filing fraudulent certificate, or for
failing to provide notice, under this section, see section
7205.

16 **“SEC. 3484. REFUND OF TAX TO INDIVIDUALS.**

17 “(a) GENERAL RULE.—Except as provided in subsec-
18 tion (e), the tax deducted and withheld under this chapter
19 with respect to amounts received by an individual during
20 any quarter (other than the fourth quarter) of his taxable
21 year (together with any tax so deducted and withheld on
22 amounts which were received by him during any prior quar-
23 ter of such year and with respect to which no allowable claim

1 for refund has been filed under this section) shall, to the
2 extent such tax does not exceed his refund allowance as of
3 the time the claim for refund is filed, be promptly refunded
4 to him as an overpayment of tax. A refund of tax shall be
5 made under this section only if the amount claimed and
6 allowable equals or exceeds \$10.

7 “(b) REFUND ALLOWANCE.—For purposes of this sec-
8 tion, the refund allowance of an individual as of the time the
9 claim for refund is filed is an amount equal to the excess, if
10 any, of—

11 “(1) an amount equal to 22 percent of—

12 “(A) the total of the deductions which, on the
13 basis of facts existing at the time the claim for refund
14 is filed, such individual would be allowed for the tax-
15 able year under section 151 (relating to deductions
16 for personal exemptions), plus

17 “(B) in the case of an individual who, at the
18 time the claim for refund is filed, reasonably ex-
19 pects that he will be allowed a credit under section
20 37 (relating to retirement income) for the taxable
21 year, the amount which, at such time, such individ-
22 ual reasonably expects to be the amount of his
23 retirement income (as defined in section 37 (c) and
24 as limited by section 37 (d)) for the taxable year,
25 less

1 “(C) the amounts (other than amounts on
2 which tax is required to be deducted and withheld
3 under this chapter) which, at the time the claim for
4 refund is filed, such individual reasonably expects
5 to be includible in his gross income for the taxable
6 year; over

7 “(2) the amounts of tax with respect to which an
8 allowable claim for refund has been previously filed
9 under this section during the taxable year.

10 For purposes of paragraph (1) (C), an individual who
11 files more than one claim for refund under this section for
12 any taxable year may use the estimate for the preceding
13 claim for such year unless, at the time he files the claim,
14 he reasonably expects the amounts referred to in paragraph
15 (1) (C) to exceed such prior estimate by more than \$100.

16 “(c) **MARRIED INDIVIDUALS.**—For purposes of subsec-
17 tions (a), (b), and (d), married individuals shall be treated
18 as an individual if, at the time the claim for refund is filed,
19 they reasonably expect that they will file a joint return for
20 the taxable year in which such claim is filed.

21 “(d) **TIME FOR FILING CLAIM.**—Not more than one
22 claim may be filed under this section by any individual
23 during any quarter of his taxable year. A refund of tax
24 deducted and withheld on amounts received during a taxable

1 year shall be made under this section only if claim therefor
2 is filed on or before the last day of such taxable year.

3 “(e) INDIVIDUALS NOT ELIGIBLE FOR REFUND.—No
4 claim for refund may be filed under this section by—

5 “(1) any individual (other than an individual
6 referred to in paragraph (2) or (3)) unless, at the
7 time the claim for refund is filed, he reasonably expects
8 that his gross income for the taxable year will not ex-
9 ceed \$5,000;

10 “(2) any married individual unless, at the time the
11 claim for refund is filed, he reasonably expects that the
12 aggregate gross income of such individual and his spouse
13 for the taxable year will not exceed \$10,000;

14 “(3) a head of a household (as defined in section
15 1 (b) (2)) or a surviving spouse (as defined in section
16 2 (b)) unless, at the time the claim for refund is filed,
17 he reasonably expects that his gross income for the
18 taxable year will not exceed \$10,000; or

19 “(4) any child, unless, at the time the claim for
20 refund is filed, he reasonably expects that no deduction
21 would be allowed for him under section 151 (e) (1) (B)
22 for the taxable year of his parent (or parents) begin-
23 ning with or within the calendar year in which the
24 claim for refund is filed.

1 “(f) CROSS REFERENCE.—

 “**For credit or refund of amounts not refunded under
this section, see section 39.**

2 “**SEC. 3485. REFUND OF TAX TO STATES, TAX-EXEMPT**
3 **ORGANIZATIONS, ETC.**

4 “(a) GENERAL RULE.—In the case of a person which
5 is—

6 “(1) the United States or a State,

7 “(2) an organization (other than a cooperative
8 described in section 521) which is exempt from the tax
9 imposed by chapter 1,

10 “(3) a foreign government or international organi-
11 zation, or

12 “(4) a foreign central bank of issue,

13 if the tax deducted and withheld under this chapter with re-
14 spect to amounts received by such person during any calendar
15 quarter exceeds the credit, if any, claimed by and allowable
16 to such person under section 3505 (relating to credit against
17 employment taxes) for such quarter, the excess (together
18 with any such excess for any prior quarter of the same
19 calendar year with respect to which no refund has been
20 claimed and allowed under this section) shall be promptly
21 refunded or credited to such person as an overpayment of
22 tax. In the case of a person to which paragraph (4) ap-
23 plies, the amount which may be refunded or credited under

1 this section shall not exceed the amount of tax deducted
2 and withheld under section 3451 on interest paid on obliga-
3 tions of the United States which are not held for, or used in
4 connection with, the conduct of commercial banking functions
5 or other commercial activities.

6 “(b) CROSS REFERENCES.—

“(1) For period of limitation for filing claim under this section, see section 6511.

“(2) For presumed date of payment for purposes of (A) period of limitation, see section 6513(b), and (B) allowance of interest on overpayments, see section 6611(d).

7 “SEC. 3486. REFUND OF TAX TO CORPORATION.

8 “(a) GENERAL RULE.—If the tax deducted and with-
9 held under this chapter with respect to amounts received by
10 a corporation (other than a corporation described in section
11 3485 (a)) during any quarter (other than the fourth quar-
12 ter) of its taxable year exceeds the amount claimed by and
13 allowable to such corporation under section 3487 as a credit
14 against its liability for tax under this chapter for such quar-
15 ter, the excess (together with any such excess for any prior
16 quarter of the same year with respect to which no refund has
17 been claimed and allowed under this section) shall be
18 promptly refunded or credited to such corporation as an over-
19 payment of tax. A refund of tax shall be made under this
20 section only if claim therefor is filed after the close of the
21 period covered by the claim and on or before the last day
22 of the taxable year.

1 “(b) CROSS REFERENCE.—

 “**For credit or refund of amounts not refunded under
this section, see section 39.**

2 “**SEC. 3487. CREDIT FOR TAX WITHHELD ON CORPO-**
3 **RATION.**

4 “(a) GENERAL RULE.—Any tax deducted and with-
5 held under this chapter with respect to amounts received
6 by a corporation (other than a corporation described in sec-
7 tion 3485 (a)) during a taxable year shall, to the extent not
8 claimed and allowable as a credit or refund to the corporation
9 under section 3486, be allowed, under regulations prescribed
10 by the Secretary or his delegate, as a credit against (but
11 not in excess of) the tax for which such corporation is liable
12 under this chapter in respect of amounts paid by it during
13 such year.

14 “(b) DIVIDENDS AND PATRONAGE DIVIDENDS PAID
15 DURING TAXABLE YEAR.—For purposes of determining the
16 credit allowable to any corporation under subsection (a), a
17 dividend, or amount subject to withholding under section
18 3471, paid by it may be considered as having been paid
19 during the taxable year—

20 “(1) in the case of a personal holding company, if
21 treated as paid during such taxable year under section
22 563 (b),

23 “(2) in the case of a regulated investment com-

pany, if treated as paid during such taxable year under section 855 (a) ,

“(3) in the case of a real estate investment trust, if treated as paid during such taxable year under section 858 (a) , or

“(4) in the case of a cooperative described in section 1381 (a) , if paid during the payment period (as defined in section 1382 (d)) for such taxable year.

“(c) **SPECIAL RULE FOR CORPORATIONS WHICH ARE MEMBERS OF AN AFFILIATED GROUP.**—To the extent and subject to such conditions as may be provided in regulations prescribed by the Secretary or his delegate, the tax deducted and withheld under this chapter with respect to amounts received by a corporation which is a member of an affiliated group which filed a consolidated return for the preceding taxable year of the affiliated group may, for purposes of this section, be treated as tax deducted and withheld under this chapter from any corporation which is a member of the same affiliated group.

“SEC. 3488. OBLIGATION SOLD BETWEEN INTEREST-PAYMENT DATES.

“For purposes of any credit or refund provided in section 3484, 3485, 3486, or 3487, in the case of an obligation which is sold or exchanged between interest-payment dates the amount required to be deducted and withheld on

1 the interest at the end of the interest-payment period shall
2 be treated in the manner provided in section 39(c).

3 **“SEC. 3489. PRESUMPTION.**

4 “For purposes of establishing that any person is entitled
5 to a credit or refund of any tax required to be deducted and
6 withheld under this chapter with respect to amounts received
7 by such person, the correct amount of such tax shall, in the
8 absence of evidence to the contrary, be presumed to have
9 been so deducted and withheld.

10 **“SEC. 3490. DEFINITIONS.**

11 “For purposes of this chapter—

12 “(1) **PERSON.**—The term ‘person’ includes the
13 United States, a State, a foreign government, and an
14 international organization.

15 “(2) **STATE.**—The term ‘State’ includes a State, the
16 District of Columbia, a possession of the United States,
17 any political subdivision of any of the foregoing, and any
18 wholly owned agency or instrumentality of any one or
19 more of the foregoing.

20 “(3) **FOREIGN GOVERNMENT.**—The term ‘foreign
21 government’ includes a foreign government, a politi-
22 cal subdivision of a foreign government, and any wholly

owned agency or instrumentality of any one or more of the foregoing.

“(4) NONRESIDENT ALIEN.—The term ‘nonresident alien individual’ includes an alien resident of Puerto Rico.”

(2) CLERICAL AMENDMENTS, ETC.—

(A) The heading for subtitle C is amended to read as follows:

“Subtitle C—Employment Taxes and Collection of Income Tax at Source”

(B) The table of chapters for subtitle C is amended by striking out the last line and inserting in lieu thereof the following:

“CHAPTER 25. Collection of income tax at source on interest, dividends, and patronage dividends.

“CHAPTER 26. General provisions relating to employment taxes and collection of income taxes at source.”

(C) The table of subtitles under the heading “Internal Revenue Title” at the beginning of the Internal Revenue Code of 1954 is amended by striking out the third line and inserting in lieu thereof the following:

“SUBTITLE C. Employment taxes and collection of income tax at source.”

1 (D) The heading for chapter 26 (as redesign-
 2 nated by paragraph (1) of this subsection) is
 3 amended to read as follows:

4 **“CHAPTER 26—GENERAL PROVISIONS RE-**
 5 **LATING TO EMPLOYMENT TAXES AND**
 6 **COLLECTION OF INCOME TAXES AT**
 7 **SOURCE”**

8 (b) CREDITS AGAINST INCOME TAX FOR TAX WITH-
 9 HELD.—

10 (1) ALLOWANCE OF CREDIT.—Part IV of sub-
 11 chapter A of chapter 1 (relating to credits against tax)
 12 is amended by inserting after section 38 (added by
 13 section 2 of this Act) the following new section:

14 **“SEC. 39. TAX WITHHELD ON INTEREST, DIVIDENDS, AND**
 15 **PATRONAGE DIVIDENDS.**

16 “(a) GENERAL RULE.—Under regulations prescribed
 17 by the Secretary or his delegate, the tax deducted and with-
 18 held under chapter 25 (relating to withholding at source
 19 on interest, dividends, and patronage dividends) shall be
 20 allowed, to the recipient of the amount with respect to which
 21 such tax was deducted and withheld, as a credit against the
 22 tax imposed by this subtitle for the taxable year in which
 23 such amount is received.

24 “(b) SPECIAL RULE FOR DEPENDENT CHILDREN.—If—

25 “(1) the taxpayer for his taxable year is entitled

1 to a deduction under section 151 (e) (1) (B) with re-
2 spect to a child, and

3 “(2) such child had, for the calendar year ending
4 with or within the taxpayer’s taxable year—

5 “(A) gross income of less than \$600, and

6 “(B) no wages (as defined in section 3401
7 (a)) with respect to which withholding was re-
8 quired under chapter 24,

9 then, under regulations prescribed by the Secretary or his
10 delegate, the taxpayer shall be entitled to the credit pro-
11 vided by subsection (a) with respect to amounts received
12 by such child during such calendar year, but only if such
13 child has not filed any claim for credit or refund of any por-
14 tion of the tax deducted and withheld with respect to such
15 amounts.

16 “(c) APPORTIONMENT OF CREDIT.—For purposes of
17 subsection (a), if an obligation is sold or exchanged between
18 interest-payment dates—

19 “(1) so much of the amount required to be deducted
20 and withheld on the interest at the end of the interest-
21 payment period as is properly allocable to that part of
22 such period which ends on the date of the sale or ex-
23 change shall be treated as an amount deducted and with-
24 held from the transferor on the date of the sale or
25 exchange, and

1 “(2) so much of such amount as is properly al-
2 locable to that part of such period which begins on the
3 day after the date of the sale or exchange shall be treated
4 as an amount deducted and withheld from the transferee.

5 “(d) LIMITATIONS.—The credit provided by subsection
6 (a) shall not be allowed—

7 “(1) REFUND TO INDIVIDUALS.—To any indi-
8 vidual with respect to any amount of tax allowed him
9 as a refund under section 3484.

10 “(2) CREDIT OR REFUND TO STATES, ETC.—To
11 any person with respect to any amount of tax allowable
12 to such person as a credit or refund under section 3485
13 or as a credit under section 3505.

14 “(3) CREDIT OR REFUND TO CORPORATIONS.—To
15 any person with respect to any amount of tax allowed
16 such person as a credit or refund under section 3486 or
17 as a credit under section 3487.

18 “(4) CERTAIN DEPENDENT CHILDREN.—To any
19 person with respect to any amount of tax which has
20 been claimed and is allowable as a credit to such
21 person’s parent by reason of the provisions of subsection
22 (b).

23 “(5) NOMINEES, ETC.—To any person with respect
24 to any amount of tax allowed such person as a credit
25 under section 1444 (b).”

1 (2) COMMON TRUST FUNDS.—Section 584 (c) (re-
2 relating to the income of participants in the fund) is
3 amended by adding at the end thereof the following
4 new paragraph:

5 “(3) TAX WITHHELD AT SOURCE ON INTEREST,
6 DIVIDENDS, AND PATRONAGE DIVIDENDS.—In any case
7 where tax under chapter 25 is deducted and withheld
8 on any amounts received by a common trust fund, for
9 purposes of any credit or refund provided in section 39
10 or 3505, or chapter 25, such tax shall, in accordance
11 with regulations prescribed by the Secretary or his dele-
12 gate, be considered as having been deducted and with-
13 held proportionately from each participant.”

14 (3) ESTATES AND TRUSTS.—Section 642 (a) (re-
15 lating to special rules for credits and deductions in the
16 case of estates and trusts) is amended by adding at the
17 end thereof the following new paragraph:

18 “(4) TAX WITHHELD AT SOURCE ON INTEREST,
19 DIVIDENDS, AND PATRONAGE DIVIDENDS.—In any case
20 where tax under chapter 25 is deducted and withheld
21 on any amounts received by an estate or trust, for pur-
22 poses of any credit or refund provided in section 39
23 or 3505, or chapter 25, such tax shall, in accordance
24 with regulations prescribed by the Secretary or his dele-
25 gate, be considered as having been deducted and with-

1 held from each beneficiary in an amount which, when
2 added to the amounts paid, credited, or required to be
3 distributed to him, equals the amounts which would
4 have been paid, credited, or required to be distributed
5 to him in the absence of chapter 25. Any tax under
6 chapter 25 which is deducted and withheld on amounts
7 received by the estate or trust shall be considered as
8 withheld from such estate or trust to the extent it is
9 not considered as withheld from a beneficiary under
10 the provisions of the preceding sentence.”

11 (4) TECHNICAL AMENDMENTS.—

12 (A) Section 164(b) (1) (relating to deduc-
13 tion denied in the case of certain taxes) is amended
14 by—

15 (i) striking out the word “and” at the end
16 of subparagraph (B) ;

17 (ii) striking out the comma at the end of
18 subparagraph (C) and inserting “; and”; and

19 (iii) adding after subparagraph (C) the
20 following new subparagraph:

21 “(D) the tax withheld at source under chapter

1 25 (relating to collection of income tax at source
2 on interest, dividends, and patronage dividends),”.

3 (B) Section 874 (a) (relating to allowance of
4 deductions and credits to nonresident alien indi-
5 viduals) is amended by striking “31 and 32” and
6 inserting in lieu thereof “31, 32, and 39”.

7 (C) Section 1314 (e) (relating to inapplica-
8 bility of part II of subchapter Q of chapter 1 of
9 subtitle A to taxes imposed by subtitle C) is
10 amended by striking “employment taxes” and in-
11 serting in lieu thereof “employment taxes and
12 collection of income tax at source”.

13 (D) Section 6211 (b) (1) (relating to rules
14 applicable in determination of deficiency) is
15 amended by striking “31” and inserting in lieu
16 thereof “31 or 39”.

17 (E) The table of sections for part IV of sub-
18 chapter A of chapter 1 is amended by striking out

“Sec. 38. Overpayments of tax.”

19 and inserting in lieu thereof

“Sec. 38. Investment in certain depreciable property.

“Sec. 39. Tax withheld on interest, dividends, and patronage
dividends.

“Sec. 40. Overpayments of tax.”

1 (c) INTEREST AND DIVIDENDS PAID TO NONRESIDENT
2 ALIENS, ETC.—

3 (1) WITHHOLDING RATE.—

4 (A) Section 1441 (relating to withholding of
5 tax on nonresident aliens) is amended by adding at
6 the end thereof the following new subsection:

7 “(e) TREATIES.—In the case of amounts described in
8 section 3452 (a) (relating to interest), section 3462 (a)
9 (relating to dividends), and section 3472 (a) (relating to
10 patronage dividends), the tax required to be deducted and
11 withheld under subsection (a) shall not by reason of the
12 provisions of any treaty be less than 20 percent of such
13 amounts.”

14 (B) Section 1442 (relating to withholding of
15 tax on foreign corporations) is amended by adding
16 at the end thereof the following new sentence: “In
17 the case of amounts described in section 3452 (a)
18 (relating to interest), section 3462 (a) (relating to
19 dividends), and section 3472 (a) (relating to pa-
20 tronage dividends), the tax required to be deducted
21 and withheld under the preceding sentence shall
22 not by reason of the provisions of any treaty be
23 less than 20 percent of such amounts.”

24 (2) NOMINEES, ETC.—Subchapter A of chapter
25 3 (relating to withholding of tax on nonresident aliens

1 and foreign corporations) is amended by adding at the
2 end thereof the following new section:

3 **"SEC. 1444. INTEREST AND DIVIDENDS PAID TO NOMI-**
4 **NEES; CREDITS TO WITHHOLDING AGENTS.**

5 "(a) WITHHOLDING OF TAX BY PAYOR.—Under regu-
6 lations prescribed by the Secretary or his delegate, every
7 person who pays amounts subject to withholding under
8 chapter 25 and who has been notified by a payee thereof that
9 the payee is a nominee required to deduct and withhold
10 on such amounts under section 1441 or 1442 shall, in
11 lieu of the nominee, deduct and withhold from such amounts
12 paid to the nominee the tax required to be deducted and
13 withheld under section 1441 or 1442, in the same manner
14 as if such amounts were paid by such person directly to the
15 beneficial owner thereof.

16 "(b) CREDITS TO WITHHOLDING AGENTS.—In the case
17 of any person who is required to deduct and withhold tax
18 under section 1441 or 1442 in respect of amounts received
19 by him during any calendar year on which tax was deducted
20 and withheld (or, in the case of amounts described in section
21 39 (c) (1), was treated as deducted and withheld) under
22 chapter 25, the taxes so deducted and withheld (or treated
23 as deducted and withheld) under chapter 25 shall, under
24 regulations prescribed by the Secretary or his delegate, be
25 allowed as a credit against (but not in excess of) his liability

1 for the year in respect of the taxes imposed by sections 1441
2 and 1442.”

3 (3) CLERICAL AMENDMENT.—The table of sec-
4 tions for subchapter A of chapter 3 is amended by add-
5 ing at the end thereof the following:

“Sec. 1444. Interest and dividends paid to nominees; credits
to withholding agents.”

6 (d) CREDIT FOR STATES AND TAX-EXEMPT ORGANI-
7 ZATIONS.—

8 (1) ALLOWANCE OF CREDIT.—Chapter 26 (gen-
9 eral provisions relating to employment taxes and income
10 tax withheld at source) is amended by adding at the
11 end thereof the following new section:

12 “SEC. 3505. SPECIAL CREDIT IN CASE OF STATES OR TAX-
13 EXEMPT ORGANIZATIONS.

14 “(a) GENERAL RULE.—In the case of a person which is
15 a State (as defined in section 3490 (2)) or which is an or-
16 ganization (other than a cooperative described in section
17 521) which is exempt from the tax imposed by chapter
18 1, the tax deducted and withheld under chapter 25 with
19 respect to amounts received by it during any calendar
20 quarter shall be allowed, under regulations prescribed
21 by the Secretary or his delegate, as a credit against
22 (but not in excess of) such person’s liability (after the
23 adjustments, if any, provided for in sections 6205 (a)

1 and 6413 (a)) for such quarter in respect of the taxes
 2 imposed by chapter 21 (Federal Insurance Contributions
 3 Act) and by chapter 24 (collection of income tax at source
 4 on wages). Such credit shall be allowed only if claim
 5 therefor is made, in accordance with such regulations, at the
 6 time of the filing of the return with respect to the taxes under
 7 chapter 21 and chapter 24 for such quarter.

8 “(b) OBLIGATIONS SOLD BETWEEN INTEREST-PAY-
 9 MENT DATES.—For purposes of this section, in the case of
 10 an obligation which is sold or exchanged between interest-
 11 payment dates, the amount required to be deducted and with-
 12 held on the interest at the end of the interest-payment period
 13 shall be treated in the manner provided in section 39 (c).

14 “(c) CROSS REFERENCE.—

“For refund under chapter 25, see section 3485.”

15 (2) TECHNICAL AMENDMENTS.—

16 (A) Section 3502 (relating to nondeductibil-
 17 ity of taxes in computing taxable income) is
 18 amended by adding at the end thereof the following
 19 new subsection:

20 “(c) The tax deducted and withheld under chapter 25
 21 shall not be allowed as a deduction in computing taxable
 22 income under subtitle A either to the person deducting and
 23 withholding the tax or to the recipient of the amounts sub-
 24 ject to withholding.”

1 (B) The table of sections for chapter 26 is
2 amended by adding at the end thereof the following:

 “Sec. 3505. Special credit in case of States or tax-exempt
 organizations.”

3 (e) OTHER TECHNICAL AMENDMENTS.—

4 (1) DECLARATION OF ESTIMATED INCOME TAX
5 BY INDIVIDUALS.—Section 6015 (a) (relating to dec-
6 laration of estimated income tax by individuals) is
7 amended by striking out the period at the end of para-
8 graph (2) and inserting in lieu thereof “and amounts on
9 which tax is required to be deducted and withheld under
10 chapter 25.”.

11 (2) ADJUSTMENT OF TAX; UNDERPAYMENT.—

12 (A) Subsection (a) (1) of section 6205 (re-
13 lating to special rules relating to assessment of em-
14 ployment taxes) is amended by striking out “or
15 3402 is paid with respect to any payment of
16 wages or compensation,” and inserting in lieu there-
17 of “3402, 3451, 3461, or 3471 is paid with respect
18 to any payment of remuneration, interest, divi-
19 dends, or other amounts,”.

20 (B) Subsection (b) of such section is amended
21 by striking out “or 3402 is paid or deducted with re-
22 spect to any payment of wages or compensation”
23 and inserting in lieu thereof “3402, 3451, 3461, or

3471 is paid or deducted with respect to any payment of remuneration, interest, dividends, or other amounts”.

(C) The heading for such section is amended to read as follows:

“SEC. 6205. SPECIAL RULES APPLICABLE TO CERTAIN TAXES UNDER SUBTITLE C.”

(D) The table of sections for subchapter A of chapter 63 is amended by striking out

“Sec. 6205. Special rules applicable to certain employment taxes.”

and inserting in lieu thereof

“Sec. 6205. Special rules applicable to certain taxes under subtitle C.”

(3) **USE OF GOVERNMENT DEPOSITARIES.**—Section 6302 (c) (relating to use of Government depositaries) is amended by adding at the end thereof the following new sentence: “The Secretary or his delegate shall not require the deposit under this subsection of any tax deducted and withheld under chapter 25 (relating to collection of income tax at source on interest, dividends, and patronage dividends) in a Government depositary before the last day prescribed in section 3481 for payment of the tax.”

(4) **EXCESSIVE WITHHOLDING.**—Section 6401

1 (b) (relating to excessive withholding) is amended to
2 read as follows:

3 “(b) EXCESSIVE WITHHOLDING.—If the amounts al-
4 lowable as credits under section 31 (relating to credit for tax
5 withheld at source under chapter 24) and section 39 (relat-
6 ing to credit for tax withheld on interest, dividends, and
7 patronage dividends under chapter 25) exceed the taxes
8 imposed by chapter 1 against which such credits are allow-
9 able, the amount of such excess shall be considered an over-
10 payment.”

11 (5) ADJUSTMENT OF TAX; OVERPAYMENT.—

12 (A) Subsection (a) (1) of section 6413 (re-
13 lating to special credit and refund rules applicable
14 to certain employment taxes) is amended by striking
15 out “or 3402 is paid with respect to any payment
16 of remuneration,” and inserting in lieu thereof
17 “3402, 3451, 3461, or 3471 is paid with respect
18 to any payment of remuneration, interest, dividends,
19 or other amounts,”.

20 (B) Subsection (b) of such section is
21 amended—

22 (i) By striking from the heading of such
23 subsection the words “OF CERTAIN EMPLOY-
24 MENT TAXES”; and

25 (ii) By striking out “or 3402 is paid or

deducted with respect to any payment of remuneration” and inserting in lieu thereof “3402, 3451, 3461, or 3471 is paid or deducted with respect to any payment of remuneration, interest, dividends, or other amounts”.

(C) The following new subsection is added at the end of such section:

“(e) CROSS REFERENCES.—

“For special refunds or credits of tax withheld on interest, dividends, or patronage dividends under chapter 25, see sections 3484, 3485, 3486, 3487, and 3505.”

(D) The heading for such section is amended to read as follows:

“SEC. 6413. SPECIAL RULES APPLICABLE TO CERTAIN TAXES UNDER SUBTITLE C.”

(E) The table of sections for subchapter B of chapter 65 is amended by striking out

“Sec. 6413. Special rules applicable to certain employment taxes.”

and inserting in lieu thereof.

“Sec. 6413. Special rules applicable to certain taxes under subtitle C.”

(6) OVERPAYMENT NOT DEDUCTED AND WITHHELD.—Section 6414 (relating to income tax withheld) is amended by striking “chapter 3” and inserting in lieu thereof “chapter 3 or 25”.

1 (7) TIME TAX CONSIDERED PAID.—Section 6513
2 (b) (relating to time tax considered paid) is amended
3 by adding at the end thereof the following new sen-
4 tences: “For purposes of section 6511 or 6512, any
5 tax deducted and withheld under chapter 25 which is
6 allowable under section 39, 3484, 3485, or 3486
7 as a credit against tax or as a refund of an overpayment
8 (or an amount treated as an overpayment) of the tax
9 imposed by chapter 1 shall, in respect of the person en-
10 titled to such credit or refund, be deemed to have been
11 paid by him on the last day prescribed for filing the re-
12 turn (determined without regard to any extension of
13 time for filing such return) of tax under chapter 1 for
14 his taxable year in which the amount subject to with-
15 holding under chapter 25 is received by him or, if such
16 person has no taxable year, on the fifteenth day of the
17 fifth calendar month following the close of such person’s
18 annual accounting period within which such amount
19 is received by him. In the case of an amount allowable
20 as a credit under section 39 (b) to the parent of a child,
21 such amount shall, if claimed by the parent, be deemed
22 to have been paid on the last day for filing his return
23 (determined without regard to any extension of time
24 for filing such return) for his taxable year which begins
25 with or within the calendar year in which amounts sub-

ject to withholding under chapter 25 were received by the child.”

(8) FAILURE TO PAY ESTIMATED INCOME TAX.—

(A) INDIVIDUALS.—Subsections (e) and (f) of section 6654 (relating to failure by individual to pay estimated income tax) are amended to read as follows:

“(e) APPLICATION OF SECTION IN CASE OF WITHHELD TAXES.—For purposes of applying this section—

“(1) the estimated tax shall be computed without any reduction for amounts which the individual estimates as his credits under section 31 (relating to tax withheld at source on wages) and section 39 (relating to tax withheld on interest, dividends, and patronage dividends); and

“(2) the amount of the credits allowed under sections 31 and 39 for the taxable year shall be deemed a payment of estimated tax, and an equal part of such amount shall be deemed paid on each installment date (determined under section 6153) for such taxable year, unless the taxpayer establishes the dates on which all amounts were actually withheld (or in the case of amounts described in section 39(c)(1), were treated as withheld), in which case the amounts so withheld

1 shall be deemed payments of estimated tax on such
2 dates.

3 “(f) TAX COMPUTED AFTER APPLICATION OF
4 CREDITS AGAINST TAX.—For purposes of subsections (b)
5 and (d), the term ‘tax’ means the tax imposed by chapter
6 1 reduced by the credits against tax allowed by part IV of
7 subchapter A of chapter 1, other than the credits against
8 tax provided by section 31 (relating to tax withheld on
9 wages) and section 39 (relating to tax withheld on interest,
10 dividends, and patronage dividends).”

11 (B) CORPORATIONS.—Section 6655 (relating
12 to failure by corporation to pay estimated income
13 tax) is amended—

14 (i) by striking out the period at the end
15 of subsection (e) (2) (B) and inserting in lieu
16 thereof “, other than the credit against tax
17 provided by section 39 (relating to tax with-
18 held on interest, dividends, and patronage divi-
19 dends).”; and

20 (ii) by redesignating subsection (f) as
21 subsection (g) and inserting after subsection
22 (e) the following new subsection:

23 “(f) APPLICATION OF SECTION IN CASE OF TAX
24 WITHHELD ON INTEREST, DIVIDENDS, AND PATRONAGE
25 DIVIDENDS.—For purposes of applying this section—

1 “(1) the estimated tax shall be computed without
2 any reduction for the amount which the corporation
3 estimates as its credit under section 39 (relating to tax
4 withheld on interest, dividends, and patronage divi-
5 dends) ; and

6 “(2) the amount of the credit allowed under sec-
7 tion 39 for the taxable year shall be deemed a payment
8 of estimated tax, and an equal part of such amount shall
9 be deemed paid on each installment date (determined
10 under section 6154) for such taxable year, unless the
11 corporation establishes the dates on which all amounts
12 were actually withheld (or in the case of amounts de-
13 scribed in section 39 (c) (1) , were treated as withheld) ,
14 in which case the amounts so withheld shall be deemed
15 payments of estimated tax on such dates.”

16 (9) PENALTY FOR FILING FRAUDULENT EXEMP-
17 TION CERTIFICATE.—Section 7205 (relating to fraudu-
18 lent withholding exemption certificate or failure to sup-
19 ply information) is amended by adding the following
20 new sentence at the end thereof: “Any person who
21 willfully files an exemption certificate with any with-
22 holding agent under section 3483, on which the certifica-
23 tion is known by him to be fraudulent or to be false as
24 to any material matter, or who is required to file a notice

1 under subsection (a) (3) (B) of section 3483 and who
 2 willfully fails to provide such notice in the manner, at
 3 the time, and showing the information required under
 4 such subsection (a) (3) (B), or the regulations pre-
 5 scribed thereunder, shall, in lieu of any penalty otherwise
 6 provided, upon conviction thereof, be fined not more than
 7 \$500, or imprisoned not more than 1 year, or both."

8 (10) OFFENSES WITH RESPECT TO COLLECTED
 9 TAXES.—The last sentence of section 7215 (b) (relating
 10 to offenses with respect to collected taxes) is amended to
 11 read as follows: "For purposes of paragraph (2), a lack
 12 of funds existing immediately after the payment of wages
 13 or amounts subject to withholding under chapter 25
 14 (whether or not created by the payment of such wages
 15 or amounts) shall not be considered to be circumstances
 16 beyond the control of a person."

17 (11) DEFINITION OF WITHHOLDING AGENT.—Sec-
 18 tion 7701 (a) (16) (defining the term "withholding
 19 agent") is amended by striking out "or 1461" and in-
 20 serting in lieu thereof "1461, 3451, 3461, or 3471".

21 (f) EFFECTIVE DATES.—

22 (1) GENERAL RULE.—Except as provided in para-
 23 graph (2), the provisions of this section shall apply in
 24 the case of interest and dividends paid on or after Jan-
 25 uary 1, 1963.

(2) SPECIAL RULES.—

(A) In the case of transferable obligations described in paragraph (1) or (6) of section 3452 (a) of the Internal Revenue Code of 1954, the provisions of this section shall apply only to interest paid with respect to interest-payment periods commencing on or after January 1, 1963.

(B) The provisions of this section shall apply to amounts described in section 3472 of such Code paid on or after January 1, 1963, with respect to patronage occurring on or after the first day of the first taxable year of the cooperative beginning on or after January 1, 1963.

SEC. 20. INFORMATION WITH RESPECT TO CERTAIN FOREIGN ENTITIES.

(a) INFORMATION TO BE FURNISHED BY INDIVIDUALS, DOMESTIC CORPORATIONS, ETC., WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.—Section 6038 is amended to read as follows:

“SEC. 6038. INFORMATION WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.

“(a) REQUIREMENT.—

“(1) IN GENERAL.—Every United States person shall furnish, with respect to any foreign corporation which such person controls (within the meaning of

1 subsection (d) (1)), such information as the Secretary
2 or his delegate may prescribe by regulations relating to—

3 “(A) the name, the principal place of busi-
4 ness, and the nature of business of such foreign
5 corporation, and the country under whose laws
6 incorporated;

7 “(B) the accumulated profits (as defined in
8 section 902 (c)) of such foreign corporation, in-
9 cluding the items of income (whether or not in-
10 cluded in gross income under chapter 1), deductions
11 (whether or not allowed in computing taxable in-
12 come under chapter 1), and any other items taken
13 into account in computing such accumulated profits;

14 “(C) a balance sheet for such foreign corpora-
15 tion listing assets, liabilities, and capital;

16 “(D) transactions between such foreign cor-
17 poration and—

18 “(i) such person,

19 “(ii) any other corporation which such
20 person controls, and

21 “(iii) any United States person owning,
22 at the time the transaction takes place, 10 per-
23 cent or more of the value of any class of stock
24 outstanding of such foreign corporation; and

25 “(E) a description of the various classes of

1 stock outstanding, and a list showing the name and
2 address of, and number of shares held by, each
3 United States person who is a shareholder of record
4 owning at any time during the annual accounting
5 period 5 percent or more in value of any class of
6 stock outstanding of such foreign corporation.

7 The Secretary or his delegate may also require the fur-
8 nishing of any other information which is similar or
9 related in nature to that specified in the preceding
10 sentence.

11 “(2) PERIOD FOR WHICH INFORMATION IS TO BE
12 FURNISHED, ETC.—The information required under para-
13 graph (1) shall be furnished for the annual accounting
14 period of the foreign corporation ending with or within
15 the United States person’s taxable year. The informa-
16 tion so required shall be furnished at such time and in
17 such manner as the Secretary or his delegate shall by
18 regulations prescribe.

19 “(3) LIMITATION.—No information shall be re-
20 quired to be furnished under this subsection with respect
21 to any foreign corporation for any annual accounting
22 period unless such information was required to be fur-
23 nished under regulations in effect on the first day of such
24 annual accounting period.

1 “(b) EFFECT OF FAILURE TO FURNISH INFORMA-
2 TION.—

3 “(1) IN GENERAL.—If a United States person fails
4 to furnish, within the time prescribed under paragraph
5 (2) of subsection (a), any information with respect to
6 any foreign corporation required under paragraph (1)
7 of subsection (a), then—

8 “(A) in applying section 901 (relating to
9 taxes of foreign countries and possessions of the
10 United States) to such United States person for the
11 taxable year, the amount of taxes (other than taxes
12 reduced under subparagraph (B)) paid or deemed
13 paid (other than those deemed paid under section
14 904 (d)) to any foreign country or possession of the
15 United States for the taxable year shall be reduced
16 by 10 percent, and

17 “(B) in applying sections 902 (relating to
18 foreign tax credit for corporate stockholder in
19 foreign corporation) and 957 (relating to special
20 rules for foreign tax credit) to any such United
21 States person which is a corporation (or to any per-
22 son who acquires from any other person any portion
23 of the interest of such other person in any such foreign
24 corporation, but only to the extent of such portion)
25 for any taxable year, the amount of taxes paid or

1 deemed paid by each foreign corporation with re-
2 spect to which such person is required to furnish
3 information during the annual accounting period or
4 periods with respect to which such information is
5 required under paragraph (2) of subsection (a)
6 shall be reduced by 10 percent.

7 If such failure continues 90 days or more after notice
8 by the Secretary or his delegate to the United States
9 person, then the amount of the reduction under this
10 subsection shall be 10 percent plus an additional 5 per-
11 cent for each 3-month period, or fraction thereof, dur-
12 ing which such failure to furnish information continues
13 after the expiration of such 90-day period.

14 “(2) SPECIAL RULES.—

15 “(A) No taxes shall be reduced under this sub-
16 section more than once for the same failure.

17 “(B) For purposes of this subsection, the time
18 prescribed under paragraph (2) of subsection (a)
19 to furnish information (and the beginning of the
20 90-day period after notice by the Secretary) shall
21 be treated as being not earlier than the last day on
22 which (as shown to the satisfaction of the Secretary
23 of his delegate) reasonable cause existed for failure
24 to furnish such information.

25 “(C) In applying subsections (a) and (b) of

1 section 902, and in applying subsection (a) of sec-
2 tion 956, the reduction provided by this subsec-
3 tion shall not apply for purposes of determining the
4 amount of accumulated profits in excess of in-
5 come, war profits, and excess profits taxes.

6 “(c) TWO OR MORE PERSONS REQUIRED TO FURNISH
7 INFORMATION WITH RESPECT TO SAME FOREIGN COR-
8 PORATION.—Where, but for this subsection, two or more
9 United States persons would be required to furnish informa-
10 tion under subsection (a) with respect to the same foreign
11 corporation for the same period, the Secretary or his dele-
12 gate may by regulations provide that such information shall
13 be required only from one person. To the extent practicable,
14 the determination of which person shall furnish the informa-
15 tion shall be made on the basis of actual ownership of stock.

16 “(d) DEFINITIONS.—For purposes of this section—

17 “(1) CONTROL.—A person is in control of a cor-
18 poration if such person owns stock possessing more than
19 50 percent of the total combined voting power of all
20 classes of stock entitled to vote, or more than 50 per-
21 cent of the total value of shares of all classes of stock,
22 of a corporation. If a person is in control (within the
23 meaning of the preceding sentence) of a corporation

which in turn owns more than 50 percent of the total combined voting power of all classes of stock entitled to vote of another corporation, or owns more than 50 percent of the total value of the shares of all classes of stock of another corporation, then such person shall be treated as in control of such other corporation. For purposes of this paragraph, the rules prescribed by section 318 (a) for determining ownership of stock shall apply; except that clause (i) of section 318 (a) (2) (C) shall be applied without regard to the 50 percent limitation contained in such section.

“(2) ANNUAL ACCOUNTING PERIOD.—The annual accounting period of a foreign corporation is the annual period on the basis of which such corporation regularly computes its income in keeping its books.

“(e) CROSS REFERENCES.—

“(1) For provisions relating to penalties for violations of this section, see section 7203.

“(2) For definition of the term ‘United States person’, see section 7701(a)(30).”

(b) INFORMATION AS TO ORGANIZATION OR REORGANIZATION OF FOREIGN CORPORATIONS AND AS TO ACQUISITIONS OF THEIR STOCK.—Section 6046 (relating to

1 returns as to creation or organization, or reorganization, of
2 foreign corporations) is amended to read as follows:

3 **"SEC. 6046. RETURNS AS TO ORGANIZATION OR REORGAN-**
4 **IZATION OF FOREIGN CORPORATIONS AND**
5 **AS TO ACQUISITIONS OF THEIR STOCK.**

6 **"(a) REQUIREMENT OF RETURN.**—A return comply-
7 ing with the requirements of subsection (b) shall be made
8 by—

9 **"(1)** each United States citizen or resident who
10 is an officer or director of a foreign corporation on Jan-
11 uary 1, 1963, or who becomes such an officer or director
12 at any time after such date,

13 **"(2)** each United States person who on January
14 1, 1963, owns 5 percent or more in value of the stock
15 of a foreign corporation, or who, at any time after such
16 date—

17 **"(A)** acquires stock which, when added to any
18 stock owned on January 1, 1963, has a value equal
19 to 5 percent or more of the value of the stock of a
20 foreign corporation, or

21 **"(B)** acquires an additional 5 percent or more
22 in value of the stock of a foreign corporation, and

23 **"(3)** each person who at any time after January 1,
24 1963, becomes a United States person while owning

1 5 percent or more in value of the stock of a foreign
2 corporation.

3 “(b) FORM AND CONTENTS OF RETURNS.—The re-
4 turns required by subsection (a) shall be in such form and
5 shall set forth, in respect of the foreign corporation, such
6 information as the Secretary or his delegate prescribes by
7 forms or regulations as necessary for carrying out the pro-
8 visions of the income tax laws.

9 “(c) OWNERSHIP OF STOCK.—For purposes of subsec-
10 tion (a) (2) and (3), stock owned directly or indirectly by
11 a person (including, in the case of an individual, stock owned
12 by members of his family) shall be taken into account. For
13 purposes of the preceding sentence, the family of an indi-
14 vidual shall be considered as including only his brothers
15 and sisters (whether by the whole or half blood), spouse,
16 ancestors, and lineal descendants.

17 “(d) TIME FOR FILING.—Any return required by sub-
18 section (a) shall be filed on or before the 90th day after
19 the day on which, under any provision of subsection (a), the
20 United States citizen, resident, or person becomes liable to
21 file such return.

22 “(e) CROSS REFERENCE.—

**“For provisions relating to penalties for violations of
 this section, see sections 6678 and 7203.”**

1 (c) CIVIL PENALTY FOR FAILURE TO FILE RETURN.—

2 Subchapter B of chapter 68 (relating to assessable penal-
3 ties) is amended by adding at the end thereof the following
4 new section:

5 “SEC. 6678. FAILURE TO FILE RETURNS AS TO ORGANIZA-
6 TION OR REORGANIZATION OF FOREIGN
7 CORPORATIONS AND AS TO ACQUISITIONS
8 OF THEIR STOCK.

9 “(a) CIVIL PENALTY.—In addition to any criminal
10 penalty provided by law, any person required to file a return
11 under section 6046 who fails to file such return at the time
12 provided in such section, or who files a return which does
13 not show the information required pursuant to such section,
14 shall pay a penalty of \$1,000, unless it is shown that such
15 failure is due to reasonable cause.

16 “(b) DEFICIENCY PROCEDURES NOT TO APPLY.—Sub-
17 chapter B of chapter 63 (relating to deficiency procedure
18 for income, estate, and gift taxes) shall not apply in respect
19 of the assessment or collection of any penalty imposed by
20 subsection (a).”

21 (d) TECHNICAL AMENDMENTS.—

22 (1) Section 318(b) (relating to cross references)
23 is amended by striking out “and” at the end of paragraph

(5), by striking out the period at the end of paragraph (6) and inserting in lieu thereof “; and”, and by adding at the end thereof the following:

“(7) section 6038(d)(2) (relating to information with respect to certain foreign corporations).”

(2) The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by striking out

“Sec. 6046. Returns as to creation or organization, or reorganization, of foreign corporations.”

and inserting in lieu thereof

“Sec. 6046. Returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock.”

(3) The table of sections for subchapter B of chapter 68 is amended by adding at the end thereof the following:

“Sec. 6678. Failure to file returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock.”

(e) EFFECTIVE DATE.—

(1) The amendments made by subsection (a) shall apply with respect to annual accounting periods of foreign corporations beginning after December 31, 1962.

(2) The amendments made by subsection (b) shall take effect on January 1, 1963.

1 **SEC. 21. TREATIES.**

2 Section 7852 (d) of the Internal Revenue Code of 1954
 3 (relating to treaty obligations) shall not apply in respect of
 4 any amendment made by this Act.

Union Calendar No. 599

87TH CONGRESS
 2^D SESSION

H. R. 10650

[Report No. 1447]

A BILL

To amend the Internal Revenue Code of 1954
 to provide a credit for investment in certain
 depreciable property, to eliminate certain
 defects and inequities, and for other pur-
 poses.

By Mr. Mills

MARCH 12, 1962

Referred to the Committee on Ways and Means

MARCH 16, 1962

Committed to the Committee of the Whole House on
 the State of the Union and ordered to be printed

Digest of CONGRESSIONAL PROCEEDINGS

OF INTEREST TO THE DEPARTMENT OF AGRICULTURE

OFFICE OF
BUDGET AND FINANCE

(For information only;
should not be quoted
or cited)

Issued March 23, 1962
For actions of March 22, 1962
87th-2d, No. 43

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HIGHLIGHTS: House passed bill to permit summer fallow lands to participate in feed grains program. House Rules Committee cleared tax bill. House committee voted to report Youth Conservation Corps bill. House committee voted to report bill for import-export controls on nonparticipants in multilateral cotton textile agreements. Sen. Muskie and Reps. Cooley and McIntire introduced and Sen. Muskie and Rep. McIntire discussed bills to provide supply management program for potatoes.

HOUSE

- 1. FEED GRAINS.** Passed without amendment S. 2533, to permit farmers in summer fallow areas to receive barley, corn, and grain sorghum price support and to participate in the corn and grain sorghum diversion program provided they reduce their corn and grain sorghum acreage to the extent necessary to bring their acreage of corn, grain sorghum, and barley down to not more than 80 percent of the 1959-60 average of those three crops. This bill will now be sent to the President. A similar bill, H. R. 8914, was laid on the table. pp. 4372-81
- 2. LIVESTOCK DISEASES.** The Agriculture Committee voted to report (but did not actually report) with amendments S. 860, to grant the Secretary of Agriculture additional authority to provide greater protection against the introduction and dissemination of diseases of livestock and poultry. p. D200
- 3. PERISHABLE COMMODITIES.** The Agriculture Committee voted to report (but did not actually report) with amendments S. 1037, to amend the provisions of the

Perishable Agricultural Commodities Act retarding fees, oral hearings, and relicensing of persons under the Act. p. D200

4. LOANS. The Agriculture Committee voted to report (but did not actually report) with amendments H. R. 946, to extend to oyster planters the benefits of the provisions of present law which provide for production disaster loans for farmers and stockmen. p. D200
5. COOPERATIVES. The Agriculture Committee voted to report (but did not actually report) H. R. 10374, to reduce the revolving fund available for subscriptions to the capital stock of the banks for cooperatives. p. D200
6. ELECTRIFICATION. The Agriculture Committee voted to report (but did not actually report) H. R. 10708, to amend section 203 of the Rural Electrification Act of 1936, as amended, with respect to communication service for the transmission of voice, sounds, signals, pictures, writing, or signs of all kinds through the use of electricity. p. D200
7. FOREIGN TRADE. The Agriculture Committee voted to report (but did not actually report) H. R. 10788, to amend section 204 of the Agricultural Act of 1956 to authorize the President to extend import-export controls to non-participants in multilateral cotton textile agreements. p. D200
8. CONSERVATION. The Committee on Education and Labor voted to report (but did not actually report) H. R. 10682, to authorize the establishment of a Youth Conservation Corps. p. D201
9. EDUCATION. The "Daily Digest" states that the Education and Labor Committee "ordered introduced in the House in lieu of H. R. 10390, the Adult Basic Education Act of 1962 (clean bill -- H. R. 10860)." p. D201
10. PUBLIC WORKS. Subcommittee No. 4 of the Judiciary Committee voted to report to the full committee with amendments H. J. Res. 464, to provide for the designation of the week commencing October 1, 1961, as "National Public Works Week." p. D201
11. HONEYBEES. The Agriculture Committee reported without amendment H. R. 8050, to prohibit the importation of all honeybees of the genus *Apis* in the adult stage except for research purposes by this Department or as the Secretary shall determine (H. Rept. 1477). p. 4392
12. TAXATION; COOPERATIVES. The Rules Committee reported a resolution for the consideration of H. R. 10650, the proposed Revenue Act of 1962, including revision in tax provisions relative to cooperatives (see Digest 38 for items of interest). p. 4393
13. BANKING. The Banking and Currency Committee reported without amendment H. R. 10162, to amend the Bretton Woods Agreements Act to authorize the U. S. to participate in loans to the International Monetary Fund to strengthen the international monetary system (H. Rept. 1484). p. 4393
14. APPROPRIATIONS. The Appropriations Committee was granted until midnight tonight Mar. 23, to file a report on the Labor, HEW and related agencies appropriation bill for 1963. p. 4371
15. RETIREMENT. Rep. Olsen discussed his bill H. R. 10706, to amend the Civil Service Retirement Act so as to provide for increases in annuities, eliminate

CONSIDERATION OF H.R. 10650

MARCH 22, 1962.—Referred to the House Calendar and ordered to be printed

Mr. O'NEILL, from the Committee on Rules, submitted the following

R E P O R T

[To accompany H. Res. 576]

The Committee on Rules, having had under consideration House Resolution 576, report the same to the House with the recommendation that the resolution do pass.



House Calendar No. 197

87TH CONGRESS
2^D SESSION

H. RES. 576

[Report No. 1483]

IN THE HOUSE OF REPRESENTATIVES

MARCH 22, 1962

Mr. O'NEILL, from the Committee on Rules, reported the following resolution;
which was referred to the House Calendar and ordered to be printed

RESOLUTION

1 *Resolved*, That upon the adoption of this resolution it
2 shall be in order to move that the House resolve itself into
3 the Committee of the Whole House on the State of the Union
4 for the consideration of the bill (H.R. 10650) to amend the
5 Internal Revenue Code of 1954 to provide a credit for invest-
6 ment in certain depreciable property, to eliminate certain
7 defects and inequities, and for other purposes, and all points
8 of order against said bill are hereby waived. After general
9 debate, which shall be confined to the bill, and continue not
10 to exceed eight hours, to be equally divided and controlled
11 by the chairman and ranking minority member of the Com-
12 mittee on Ways and Means, the bill shall be considered as

1 having been read for amendment. No amendment shall be
2 in order to said bill except amendments offered by direction
3 of the Committee on Ways and Means. Amendments offered
4 by direction of the Committee on Ways and Means may be
5 offered to any section of the bill at the conclusion of the
6 general debate, but said amendments shall not be subject to
7 amendment. At the conclusion of the consideration of the
8 bill for amendment, the Committee shall rise and report the
9 bill to the House with such amendments as may have been
10 adopted, and the previous question shall be considered as
11 ordered on the bill and amendments thereto to final passage
12 without intervening motion, except one motion to recommit,
13 with or without instructions.

87TH CONGRESS
2D SESSION

H. RES. 576

[Report No. 1483]

RESOLUTION

Providing for the consideration of H.R. 10650, a bill to amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes.

By Mr. O'NEILL

MARCH 22, 1962

Referred to the House Calendar and ordered to be printed

Digest of CONGRESSIONAL PROCEEDINGS

OF INTEREST TO THE DEPARTMENT OF AGRICULTURE

OFFICE OF
BUDGET AND FINANCE

(For information only;
should not be quoted
or cited)

Issued March 29, 1962
For actions of March 28, 1962
87th-2d, No. 48

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HIGHLIGHTS: Senate committee voted not to report bill to continue current support prices for milk and butterfat. House subcommittee voted to report land-use adjustment sections of farm bill. Sen. Smathers urged early enactment of long-range sugar program. Senate began debate on Treasury-Post Office-Executive Office appropriation bill. House began debate on tax bill. Rep. Randall inserted Secretary's speech.

HOUSE

- FARM PROGRAM.** The "Daily Digest" states that the Subcommittee on Conservation and Credit of the Agriculture Committee voted to report to the full committee with amendment title I, on land-use adjustment, of H. R. 10010, the omnibus farm bill. p. D219
Rep. Findley criticized the proposed Food and Agriculture Act of 1962, saying, "I will do my utmost on the Committee on Agriculture to kill the entire bill, as I am convinced that no legislation is far to be preferred to any modification of a bill that is so basically against the interests of the farmer." p. 4868
- LIVESTOCK DISEASES.** The Agriculture Committee reported with amendments S. 350, to grant the Secretary of Agriculture additional authority to provide greater protection against the introduction and dissemination of diseases of livestock and poultry (H. Rept. 1516). p. 4937

3. TAXATION; COOPERATIVES. Began debate on H. R. 10650, the proposed Revenue Act of 1962, including revisions in tax provisions relative to cooperatives (see Digest 38 for items of interest). pp. 4868-920
 4. TERRITORIES. The Interior and Insular Affairs Committee reported with amendments H. R. 10062, to extend the application of certain laws to American Samoa including extension of the provisions of the National School Lunch Act to Samoa and authorizing the USDA to make available to the territory technical, scientific, and other agricultural program assistance on a selective and limited basis (H. Rept. 1536). (p. 4937). The committee earlier voted to report this bill (p. D220).
 5. PURCHASING. The Education and Labor Committee voted to report (but did not actually report) H. R. 10946 (in lieu of H. R. 10766), to amend the Davis-Bacon Act to define the term "wages" as used in the Act, and H. R. 10786, to establish standards for hours of work and overtime pay of laborers and mechanics employed on work done under contract for, or with the financial aid of, the U. S. for any territory, or for D. C. p. D220
 6. PEACE CORPS. The Rules Committee reported a resolution for the consideration of H. R. 10700, to authorize increased appropriations for the Peace Corps. pp. 4868, 4937
 7. FOREIGN CURRENCIES. Received from the House Administration Committee the report of several committees on the expenditures of foreign currencies and appropriated funds in travel abroad. pp. 4931-7
 8. SALINE WATER. Received from Interior a report on that Department's operations during 1961 under the Saline Water Act of 1952. p. 4937
- SENATE
9. DAIRY PRICE SUPPORTS. By a vote of 11 to 5, the Agriculture and Forestry Committee voted not to report S. J. Res. 150, to continue for nine months additional the current price supports for milk and butterfat. p. D217
 10. TREASURY-POST OFFICE-EXECUTIVE OFFICE APPROPRIATION BILL, 1963. Began debate on this bill, H. R. 10526. pp. 4819, 4839-60
 11. SUGAR. Sen. Smathers urged early consideration of legislation to extend the Sugar Act, an increase in the quota of mainland cane sugar, and enactment of legislation to extend the program for at least 5 years. pp. 4804-5
 12. PEACE CORPS. The Foreign Relations Committee voted to report (but did not actually report) with amendment S. 2935, to extend and expand the Peace Corps. p. D218
 13. FORESTRY. Sen. Bennett submitted an amendment intended to be proposed to S. 2387, to provide for the establishment of the Canyonlands National Park Utah (includes National Forest lands). p. 4782
Sen. Moss urged support for legislation to establish the Canyonlands National Park. pp. 4828-31
Sen. Neuberger urged establishment of the Oregon Dunes as a national park and stated, "I firmly believe that the downgrading of the Oregon Dunes was a concession to the Department of Agriculture to give the Forest Service one beautiful area to develop for recreation." pp. 4860-1

PUERTO RICO

Moises M. Graniela-Ramirez, Boqueron.

RHODE ISLAND

Ellen L. Costanza, Bradford.

John J. Bento, Tiverton.

SOUTH CAROLINA

Huron A. Gray, Allendale.

Mozelle M. Thompson, Inman.

TENNESSEE

Joe B. Campbell, Blaine.

Fred R. Lockett, Jr., Mountain Home.

UTAH

Ethel N. Jones, Corinne.

VIRGINIA

Ernest R. Johnson, Alberta.

Alvis T. Davidson, Jr., Faber.

Walter L. Waleski, Glenallen.

E. Guy Smith, Gloucester.

J. Spencer Rogers, Melfa.

G. Hoyt McCartney, New Castle.

Virgil S. Abel, Jr., Quantico.

Horace B. Ridenour, Williamsburg.

WASHINGTON

Ada M. Conboy, Glenwood.

Keith E. Hand, Malott.

Elvin L. Jorgensen, Onalaska.

Sheldon P. Sageser, Poulsbo.

Harold C. Cochran, Snohomish.

Florence C. Blaisdell, Snoqualmie Falls.

Lillian R. LaRue, Stellacoom.

WEST VIRGINIA

George E. Nolte, Bethany.

Virginia L. Kyle, Hendricks.

John W. Waskey, Sandyville.

U.S. CIRCUIT JUDGE

J. Skelly Wright, of Louisiana, to be U.S. circuit judge for the District of Columbia circuit.

Ruth B. Hartsel, Polk.
Raphael J. Reasbeck, Salem.
John M. Tertel, Toledo.
Charles F. Seither, West Richfield.

OKLAHOMA

Grady F. Cope, Hollis.
Hobart G. Waters, Sayre.
Rex E. Pettijohn, Stigler.

OREGON

Lyle J. Chase, Rainier.
Frank G. Ryan, Tillamook.

PENNSYLVANIA

Thomas P. Lowry, Blue Bell.
Agnes M. Smith, Dunlo.
David C. Miller, High Spire.
Kathryn L. Fessler, Muir.
Marie A. Leo, New Albany.
J. Perry Hookersmith, Shippensburg.
John J. Bocinec, Tarentum.
Esther T. Williams, Thorndale.
Edward A. Lynch, Titusville.

House of Representatives

WEDNESDAY, MARCH 28, 1962

The House met at 12 o'clock noon.

The Chaplain, Rev. Bernard Braskamp, D.D., offered the following prayer:

The text of John Wesley's last sermon, Isaiah 55: 6: *Seek ye the Lord while He may be found, call ye upon Him while He is near.*

Ever blessed God, we rejoice that Thou art found by those who truly seek Thee, known by those who love, and seen by all whose hearts are pure.

Grant that daily we may be numbered among the seekers and finders of God and thus have our lives become aglow with the light and joy of the things that are worthy and eternal.

Show us how we may conserve and utilize wisely the hours of each new day and keep alive our faith in the moral and spiritual values.

Lift us out of all cynical and cold tempers of mind and heart and make us receptive and responsive to the divine call to seek Thee lest we become too despondent to hope for better days and too willful to follow Thy leading.

Hear us in the name of Jesus Christ, our Lord. Amen.

THE JOURNAL

The Journal of the proceedings of yesterday was read and approved.

MESSAGE FROM THE SENATE

A message from the Senate by Mr. McGown, one of its clerks, announced that the Senate had passed a joint resolution and a concurrent resolution of the following titles:

S.J. Res. 29. Joint resolution proposing an amendment to the Constitution of the United States relating to the qualification of electors; and

S. Con. Res. 65. Concurrent resolution designating the week of May 20 to May 26, 1962, as "National Highway Week."

PROPOSED AGRICULTURAL PRODUCTION CONTROL PROGRAM

(Mr. FINDLEY asked and was given permission to extend his remarks at this point.)

Mr. FINDLEY. Mr. Speaker, the American farmer would be far better off to have no legislation at all this year than to get the administration's production control program—H.R. 10010—or an extension of the existing feed grains program.

If the feed grains program is not extended to 1963 and no new legislation is enacted, then the 1958 program would go into effect. It is still on the books and provides no acreage allotments or planting restrictions for feed grains, and places price supports at 90 percent of the

past 3-year moving average with a floor at 65 percent of parity.

Secretary Freeman himself has stated the feed grains program now in effect is too costly for what it accomplishes. Certainly the cost of the proposed production control program in loss of efficiency, opportunity, and freedom, as well as tax cost, is staggering.

If no legislation is passed, Midwest agriculture would once more move toward a strengthened free enterprise marketplace system, with price supports related to market prices instead of parity. In both H.R. 10010 and the existing feed grains program, the marketplace system is largely replaced by Government control. Bureaucrats manipulate prices and supplies.

I will do my utmost on the Committee on Agriculture to kill the entire bill, as I am convinced that no legislation is far to be preferred to any modification of a bill that is so basically against the interests of the farmer.

CALL OF THE HOUSE

Mr. LOSER. Mr. Speaker, I make the point of order that a quorum is not present.

The SPEAKER. Evidently a quorum is not present.

Mr. ALBERT. Mr. Speaker, I move a call of the House.

A call of the House was ordered.

The Clerk called the roll, and the following Members failed to answer their names:

[Roll No. 46]

Andrews	Hoffman, Mich.	Scherer
Ashley	Jones, Ala.	Selden
Bates	Kearns	Shelley
Bennett, Mich.	Lane	Sheppard
Blitch	Minshall	Short
Bolling	Norrell	Smith, Miss.
Brooks	Nygaard	Spence
Byrne, Pa.	Peterson	Springer
Cannon	Powell	Tollefson
Colmer	Rains	Tupper
Cooley	Roberts, Ala.	Walter
Hagan, Ga.	St. Germain	Wilson, Ind.

The SPEAKER. On this rollcall, 396 Members have answered to their names, a quorum.

By unanimous consent, further proceedings under the call were dispensed with.

TO AMEND THE PEACE CORPS ACT

Mr. DELANEY, from the Committee on Rules, reported the following privileged resolution (H. Res. 579, Rept. No. 1517), which was referred to the House Calendar and ordered to be printed:

Resolved, That upon the adoption of this resolution it shall be in order to move that the House resolve itself into the Committee of the Whole House on the State of the Union for the consideration of the bill (H.R.

10700) to amend the Peace Corps Act. After general debate, which shall be confined to the bill, and shall continue not to exceed one hour, to be equally divided and controlled by the chairman and ranking minority member of the Committee on Foreign Affairs, the bill shall be read for amendment under the five-minute rule. At the conclusion of the consideration of the bill for amendment, the Committee shall rise and report the bill to the House with such amendments as may have been adopted, and the previous question shall be considered as ordered on the bill and amendments thereto to final passage without intervening motion except one motion to recommit.

AMENDING INTERNAL REVENUE CODE OF 1954

Mr. O'NEILL. Mr. Speaker, by direction of the Committee on Rules, I call up the resolution (H. Res. 576) providing for the consideration of H.R. 10650, a bill to amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes.

The Clerk read the resolution, as follows:

Resolved, That upon the adoption of this resolution it shall be in order to move that the House resolve itself into the Committee of the Whole House on the State of the Union for the consideration of the bill (H.R. 10650) to amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes, and all points of order against said bill are hereby waived. After general debate, which shall be confined to the bill, and continue not to exceed eight hours, to be equally divided and controlled by the chairman and ranking minority member of the Committee on Ways and Means, the bill shall be considered as having been read for amendment. No amendment shall be in order to said bill except amendments offered by direction of the Committee on Ways and Means. Amendments offered by direction of the Committee on Ways and Means may be offered to any section of the bill at the conclusion of the general debate, but said amendments shall not be subject to amendment. At the conclusion of the consideration of the bill for amendment, the Committee shall rise and report the bill to the House with such amendments as may have been adopted, and the previous question shall be considered as ordered on the bill and amendments thereto to final passage without intervening motion, except one motion to recommit, with or without instructions.

(Mr. O'NEILL asked and was given permission to revise and extend his remarks.)

Mr. O'NEILL. Mr. Speaker, at the conclusion of my remarks, I will yield 30 minutes to the gentleman from Ohio [Mr. BROWN].

Mr. Speaker, the resolution, House Resolution 576, provides for the consid-

eration of the bill, H.R. 10650, a bill to amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes. The resolution provides for a closed rule, waiving points of order, with 8 hours of general debate.

The bill, H.R. 10650, represents a major revision and reform of our Federal tax system.

On the one hand the investment credit provided by this bill is designed to provide a stimulant to the economic growth of this country. This is needed both to improve our competitive position abroad and in the long run to raise our standard of living at home. On the other hand, the other provisions of the bill are designed to improve the equity of our tax structure.

Estimates presented in the committee report indicate that when the provisions of the bill are fully effective a revenue loss is expected, if no effect of the provisions on the national economy is taken into account. The Treasury Department has estimated, however, that when this effect is taken into account the bill will be substantially in balance.

On April 20, 1961, the President sent to Congress a message containing a series of proposals for the revision of the present tax laws. Most of his recommendations, modified, are incorporated in this bill.

On May 3, 1961, hearings began on the President's proposals. These hearings extended over 6 weeks and the Committee on Ways and Means received testimony and comments from over 400 individuals, corporations, and organizations. Following the special hearings, they considered the President's proposal in executive session last year for a period of several weeks. Upon completion of its considerations at that time they made certain tentative decisions for the incorporation in a draft made public in order to obtain the views of interested persons. The committee print containing these suggestions was released to the public on August 24, 1961, together with a general explanation of the provisions. That print was given wide distribution and circulation. In the fall of 1961 the staff of the Committee on Ways and Means met with outside persons and worked with the Treasury Department in obtaining the views of interested parties. With the beginning of this session of Congress the committee immediately began a review of these provisions, making modifications in the earlier decisions to take into account the suggestions and recommendations received.

H.R. 10650, therefore, represents the decisions made in the committee after careful deliberation over an extended period of time.

The other part of the bill deals with the withholding tax. On this I am sure we have all received—I know I have received—probably more mail on this than on any other legislation pending before the Congress. We received on our desks a letter from the Treasury Department which I think is an excellent argument concerning that part of the bill which states that the withholding of taxes on

interest and dividend payments is essential as a matter of equity and as a matter of fiscal responsibility.

There is absolutely no reason why those who receive all or part of their income from interest and dividends should not have their taxes withheld—as wage and salary earners have been for 20 years. What is being considered is not a new or additional tax but simply a method of collecting taxes which are now owed the Government but not being paid.

I feel that it is the belief of the people of the Nation that since the ordinary Mr. John Q. Public pays his tax and it is withheld from him, then there is no reason why those who receive income in the form of unearned income from dividends should not also pay their taxes, by having the tax withheld.

In addition, the fiscal soundness of the pending bill depends heavily upon enactment of the withholding section, which is the largest single source of uncollected taxes owed. Six hundred and fifty million dollars are not going into the coffers of the U.S. Treasury which are owed to the Government of these United States by those people who have failed to pay their taxes on dividends annually.

INDIVIDUALS WOULD SUFFER NO HARDSHIP AND
LITTLE INCONVENIENCE

People with no tax liability will be excluded from the withholding system on their dividend, savings account and savings bond interest by filing a simple exemption certificate with the payer of the dividend or interest certifying that he reasonably believes he will not be liable for the payment of any income tax for the year in question. For those under age 18, the exemption certificates can be filed whether or not the individual expects to have any tax liability. Those who have some tax liability but less than the amount withheld, will apply for quarterly refunds on a simple form supplied by IRS, which will mail out quarterly reminders. Refunds will in most cases be received within a month—as they are now by the 35 million taxpayers who are overwithheld each year on their wages and salaries.

WITHHOLDING WILL PAY FOR ITSELF HUNDREDS
OF TIMES OVER

The estimated administrative cost of the withholding system is \$19 million per year but \$650 million in presently evaded taxes will be collected.

Withholding is necessary. Publicity campaigns aimed at increasing the level of voluntary reporting of interest and dividend income have simply not worked and attempted enforcement by tax return audits has been unproductive.

I think the majority of the public wants this bill passed. Those who work for salaries and wages are withheld on. Why should not those who gain their living by clipping coupons and from interest payments likewise make some payment to the Treasury of the United States?

Since the bill will be covered in detail by the Committee on Ways and Means during general debate I shall not speak further with reference to the merits of

the bill but urge the adoption of House Resolution 576.

Mr. BROWN. Mr. Speaker, I yield 1 minute to the distinguished gentleman from Illinois [Mr. MASON].

(Mr. MASON asked and was given permission to revise and extend his remarks.)

Mr. MASON. Mr. Speaker, in connection with the arguments pro and con that will be made on H.R. 10650, the tax revision bill of 1962—a bill that has some good features but is, in my opinion, an unrealistic, stopgap tax bill—I wish to submit for the consideration of the Members of the House a program for Federal tax relief that if adopted would go a long way to equalize the heavy tax burden upon the American taxpayers. It would also do away with most of the present tax inequities that are to be found in our Federal tax system and it would spread the taxload more equitably over all segments of our economy. The following is the tax program I recommend:

A PROGRAM FOR FEDERAL TAX RELIEF

Mr. Speaker, in the tax-writing Committee on Ways and Means of the Congress, 1962 has been a year of solemn contemplation of our botched-up tax structure—but with very little real remedial action. The big job of tax revision and tax reform is scheduled for next year.

The committee is well prepared for action. In three volumes of 2,382 pages and in hundreds of more pages of questions and answers, we have before the committee the wisdom of more than 150 attorneys, economists, businessmen and bankers who served as panelists in exhaustive discussions of practically every facet of Federal taxation, as well as their recommendations for revision of the whole monstrous Internal Revenue Code.

When our total taxload takes nearly one-third of the national income, something should be done to spread that taxload equitably among the various segments of our economy. Today we require certain segments of our economy to carry a disproportionate share of the total taxload. Is it, therefore, any wonder that the American taxpayer is more tax-conscious and more tax-complaining today than ever before in our history?

In fiscal year 1961 the total taxload upon American taxpayers was roughly \$120 billion. Federal taxes were \$82 billion; State taxes, \$20 billion; and local taxes, \$18 billion.

Mr. Speaker, our Federal tax load can be broken down into four different tax sources, namely: Individual income taxes, corporation income taxes, excise taxes, and miscellaneous taxes—inheredance taxes, gift taxes, and tariffs.

First. Our individual income taxes now range from 20 percent of the taxable income in the lowest bracket to 91 percent of the taxable income in the highest bracket. This means that the man in the lowest income bracket must work about 2½ months each year for the Government with only 9½ months left for himself and his family; that the man in the top tax bracket must work 11 months each year for the Government, with only 1 month left to work for himself and his family.

The yearly tax take from this source—individual income taxes—is roughly \$44 billion, or a little more than one-half of the total Federal tax load.

Second. Our corporation taxes range from 30 to 52 percent of corporation profits. This means that a corporation in the 52 percent bracket must make \$2 profit for every dollar it can hand out to its stockholders. It means also that many corporations work a little more than 6 months each year for the Federal Government and a little less than 6 months each year for their stockholders.

Corporation taxes bring in a total yearly tax take of about \$22 billion.

Third. Excise taxes are taxes levied upon the value of goods sold and upon certain services rendered. Both liquor and tobacco, however, are taxed at very high rates, disregarding the value of the goods sold.

Excise taxes bring in a tax of roughly \$10 billion.

Fourth. Our Federal inheritance taxes range up to 70 percent of the total value of the estate, while tariff rates average about 7 percent of the value of the goods imported.

Receipts from these sources amount to about \$6.7 billion per year.

Mr. Speaker, in the light of our present heavy Federal tax load and its sources three tax reforms are badly needed to spread the tax load more equitably.

The first tax reform that should be made is to place a tax ceiling or limit upon all Federal income taxes, corporation taxes, and estate taxes. This tax ceiling should be in the neighborhood of 45 percent.

Why should this be done?

In 1848, over a hundred years ago, Karl Marx announced a two-point tax program for the destruction of capitalism and the promotion of communism:

First. All estates should be confiscated through a 100-percent inheritance tax, and

Second. A steeply progressive graduated income tax should be levied upon all income.

During the past 25 years we have traveled a long way down the tax road that Karl Marx laid out. True, we have not yet reached the 100-percent confiscation of inheritances, but we do go up as high as a 70-percent inheritance tax. We have reached 91-percent confiscation of all large incomes, and we have reached a 52-percent confiscation of corporate incomes.

The second tax reform that should be made is the repeal of all present Federal excise taxes now on the books—except upon liquor and tobacco—and the substitution of a flat 5-percent manufacturers excise tax, uniformly applied at the source to all end products except food and medicine.

The repeal of present Federal excise taxes would cost the Treasury about \$5 billion per year. Imposition of a flat 5-percent manufacturers' excise tax upon all end products would produce about \$5 billion per year to make up for the loss. This change in our excise tax program

would have the following definite advantages:

First. We would get rid of the present hodge-podge, hit-and-miss, inequitable system of excise taxes—taxes levied without rhyme or reason—and we would also lower our present 10-percent excise taxes down to 5 percent.

Second. A manufacturers' excise tax is the cheapest and easiest of all taxes to administer and collect.

Third. It would tend to equalize the total tax burden upon all our people, without hurting any one producer or consumer.

The imposition of a flat manufacturers' excise tax in lieu of the present hodge-podge of excise taxes would constitute a long step forward toward the establishment of a well-balanced, equitable, and efficient Federal tax system.

The third tax reform that should be made is to bring about tax equality between business competitors. Corporations now pay a tax up to 52 percent upon their profits. Cooperatives, mutual savings banks, building and loan associations, credit unions, Government-operated businesses—all in competition with taxpaying corporations—now pay little or no Federal income taxes.

As a consequence of the present tax inequality between business competitors, the co-ops and various mutuals are able to use the major part of their profits for expansion, for buying up taxpaying enterprises in their own lines of business. Thus they keep expanding year after year, like a snowball rolling down a mountainside, gathering mass and momentum as it rolls.

Mr. Speaker, spokesmen for the co-ops have always claimed that Congress has no legal right to tax co-ops; that co-ops are simply agents for their patrons; that co-ops make no profits in the sense that corporations make profits; and therefore co-ops are not taxable. This argument of the co-op spokesmen was settled when the greatest tax authority in the Nation, the Joint Committee on Internal Revenue, rendered an opinion in 1951 saying that under our Constitution and laws, Congress does have the right to tax co-ops in the same manner and for the same reason that it now taxes corporations.

Briefly, the report of the Joint Committee entitled "The Power of Congress to Tax Cooperatives on Net Margins" pointed out:

1. Nearly all co-ops are organized as corporations and have corporate charters granted by the various States; therefore they are taxable as corporations;

2. The few not chartered as corporations are associations. The definition of a corporation in the Internal Revenue Code includes associations; therefore for Federal tax purposes they are considered corporations; and

3. For many years Congress has considered co-ops as corporations and has by legislation exempted them from the corporation tax. If Congress has the power to exempt co-ops from the corporation tax, then Congress certainly has the power to repeal that exemption.

The Joint Committee in its report has settled for all time the moot question raised by the spokesmen for the co-ops.

The Congress does have the right to tax co-ops. The real question is, "Does Congress have the courage to do so?"

So, when we come to the revision of our tax laws in 1963, I shall urge three specific reforms:

First. Lower income taxes for all individuals, with a top barrier of 45 percent beyond which we shall not go except in the emergency of war.

Second. Impose an excise tax on the end products of manufacture, to produce a far bigger part of our national revenue than retail excise taxes now bring.

Third. Tax the earnings of savings and loan associations, cooperatives, mutual savings banks, credit unions, and other mutuals exactly as the earnings of their proprietary competitors are taxed.

That is not all that is needed; but if the 88th Congress accomplishes no more than these three simple items in writing the Internal Revenue Code of 1963, it will bring to our tax system a measure of justice and equality that has been missing for 10, these many years.

I have long preached from one tax text: "We must tax the untaxed to relieve the burden of the overtaxed." More than ever, this will be my slogan next year.

Mr. BROWN. Mr. Speaker, I yield myself such time as I may use.

(Mr. BROWN asked and was given permission to revise and extend his remarks.)

Mr. BROWN. Mr. Speaker, as the gentleman from Massachusetts [Mr. O'NEILL], a member of the Rules Committee, has so ably explained, House Resolution 576, which is now before us, provides for the consideration of H.R. 10650 under a closed or a gag rule, in which all points of order are waived, and which provides for 8 hours of general debate.

Yet this resolution does not give a rule on the bill that will actually be before us today and that we will have to pass on, because H.R. 10650, as mentioned in House Resolution 576—and this rule was not granted until 5 or 6 days ago, on March 22—has been greatly changed and amended since it was printed. Of course this bill of 240 pages is not easy to understand or to comprehend. I am sure I will go unchallenged when I make the statement there is not a single individual, with perhaps the exception of the very learned and distinguished chairman of the Committee on Ways and Means in the House who knows what this bill will do, or what its effect may be or what the taxpayers of this Nation will be required to do under its provisions.

Then, of course, we have had this bill with us only a few short days ago, and neither it or the 217-page report on it, which explains the sections that are no longer in the bill, or will not be if the chairman of the Committee on Ways and Means offers the amendments he advises the Rules Committee he will offer on behalf of the committee.

So, Mr. Speaker, there is a lot of misunderstanding about the bill and the rule we have here. We are being told by the gentleman from Massachusetts

[Mr. O'NEILL] that this is a closed or gag rule. It is, or of course will be, if this resolution is adopted, at least as far as 424 Members of this House are concerned. But, it is not a closed or gag rule as far as any 13 Members of the great and distinguished Committee on Ways and Means are concerned, because any of its 13 members, under this rule, would have the authority to offer any amendment they might approve. But, that does not apply to those 424 of us who are not members of the Committee on Ways and Means. So, this is a closed or a gag rule, in one sense of the word, as far as a great majority of the Members of the House are concerned, but it is not a closed or gag rule as far as any 13 members of the Committee on Ways and Means may be concerned. Therefore, we have here an actual breakdown, if you please, of the so-called closed rule as far as 13 individual Members of this House are concerned. They can offer any amendment they wish, but the rest of us, under this rule, must go along with the bill without the privilege of offering amendments, except the privilege to offer one motion to recommit.

Now, this measure, H.R. 10650, is the latest tax bill reported out. There have been a great many versions of it. In fact, I made the remark facetiously, of course, in the Committee on Rules, when we had some of these different forms of the tax bill before us, that seemingly the committee printed more editions of the new tax bill, here on Capitol Hill, than the Washington Star printed editions of their daily newspaper.

Now, I do not know exactly what this latest edition tax bill provides, but I do know the Committee on Ways and Means of this House, which is a great committee, and upon which are a great many fine and distinguished Members, that has had about 11 months to consider this tax legislation and we, in the House as a whole, have not really had sufficient time to even read, let alone to master, all of the language contained in this 240-page bill.

Many times, in the well of this House I have opposed closed or gag rules. Not always have I opposed those on tax bills, because I have understood for a long, long time, and have so voted, that it is not easy to enact general tax legislation on the floor of the House, especially where we open up the entire Internal Revenue Code for amendment. For that reason, as I have said, I have not always opposed closed rules on tax bills. I have opposed them on other legislation. We saw here on the floor of the House last summer a situation where we voted down a rule, after we had been told it was absolutely necessary to have a closed or gag rule; I refer to the postal revenue bill. We saw the previous question voted down, and the rule amended, so that it became an open rule, yet the legislation to increase the postal revenues was voted by this House under that open rule without too much difficulty.

We have seen in the past this House, vote rules, special rules, in connection with tax bills, so as to permit the offering and consideration of certain amendments. We have seen that done on

other important legislation before the House. Not too long ago, you may remember, our own Committee on Rules reported out a rule making in order the consideration of certain civil rights legislation, and providing therein that the contents of the so-called McCulloch bill should be held in order for consideration as an amendment to the bill.

That action was approved by the Rules Committee of the House, and then the amendment was approved by the House itself. Actually, while it carried the title of the Celler bill, the content of that important reform legislation was the exact wording of the so-called McCulloch bill.

Mr. Speaker, I hope I may have the attention of the membership because I believe this is important to the Members.

I am going to do today, if I have the opportunity, which I hope to have, that which has been done in the past. I am going to ask, and I will urge if I may, with all the sincerity at my command, that this House vote down the previous question on this gag rule so it will be open to amendment, at which time, if the previous question is voted down, I will offer a substitute rule, similar to that which was considered in the Rules Committee, and which was lost by a small margin of votes. This rule would be one that would make in order the consideration of amendments to three important and controversial sections of this bill, H.R. 10650.

Mr. Speaker, some may attempt to argue this is not a proper procedure, that it has not been done in connection with tax legislation in the past. Yet I would like to refer the membership, if I may, to a rule that was adopted by this House, for the consideration of a very important tax bill a few years ago—on July 30, 1941, page 6608—a rule which made in order the consideration of a certain amendment, or amendments to the tax bill then pending before this body. That rule was approved by the House and later that amendment was also approved by the House.

Mr. Speaker, what is the suggested rule I propose to take the place of this closed or gag rule? It is a closed rule; yes, to a great extent, except in three limited areas concerning three very controversial sections of this bill, and concerning which I am sure most of you, if not all of you, have written many letters and perhaps have done as some of us have done, told constituents: "Yes; I expect to vote against that particular provision in the tax law, if I am given the opportunity to do so." Well, this simply gives you the opportunity to do so.

This proposed rule will give you the opportunity to say whether or not you want to bind and to gag yourselves so you will be impotent to the extent you cannot act, and only 13 Members will have any opportunity to say anything about amendments. Do you want to say that to your constituents? That you have voted to bind and to gag yourselves so you cannot vote for the provisions and the amendments to this bill, as you have promised, or take any action upon the sections of this bill to which you object,

or to which you advised your constituents you are opposed? This is an opportunity to see whether or not you want to work your own will in this House; whether you feel the Members of this body are just as capable, just as able, to pass upon important legislation of this kind, especially on the controversial issues—the ones that count in this bill—as is the other body of this Congress.

What is this rule that I expect to offer as a substitute, if the previous question is voted down, as we hope it will be? It provides simply this: That there be an amendment adopted to House Resolution 576, the present rule now pending before us, to strike out all after the resolving clause and insert in lieu thereof the following language. This will be in the motion that I shall make:

That upon the adoption of this resolution it shall be in order to move that the House resolve itself into the Committee of the Whole House on the State of the Union for the consideration of H.R. 10650, a bill to amend the Internal Revenue Code of 1954, and for other purposes, and all points of order against said bill are hereby waived.

That is the same provision as in this original resolution:

That after general debate, which shall be confined to the bill and shall continue not to exceed eight hours, to be equally divided and controlled by the chairman and ranking minority member of the Committee on Ways and Means, the bill shall be considered as having been read for amendment—

That is the same as in the present resolution—

No amendment shall be in order to said bill except amendments offered by direction of the Committee on Ways and Means—

That is the same as in this pending resolution—

and except one amendment—

This is the new language—

one amendment proposing to strike out section 2 and substitute therefor the language of H.R. 10906—

Which I will explain later—

and except one amendment proposing to strike out section 13 and substitute therefor the language of H.R. 10803, and except one amendment proposing to strike out section 19, any rule of the House to the contrary notwithstanding, but such amendments shall not be subject to amendments—

Which continues a closed rule on all other matters in the bill—

Amendments authorized by this resolution may be offered to any section of the bill at the conclusion of the general debate. At the conclusion of the consideration of the bill for amendment, the Committee shall rise and report the bill to the House with such amendments as may have been adopted, and the previous question shall be considered as ordered on the bill and amendments thereto to final passage without intervening motion except one motion to recommit, with or without instructions.

To what do these amendments pertain? The first amendment would deal with the section that would give certain tax credit for investments made by those who may have money to spend at the present time.

The second amendment deals only with restoring to the bill the language originally written into the measure as

prepared by the Joint Committee on Internal Revenue Taxation, which would protect the best interests of those who may invest their money abroad, as requested, and as we have said they should do under the so-called Boggs bill we passed some time ago, and as both President Eisenhower and President Kennedy have urged should be done. That is the foreign investment section of the bill.

It does not stop the closing of loopholes. It does not change that part a bit. It does not apply to the usual foreign earnings, foreign investments, and so forth, but only to corporations and the investment of their earnings made abroad.

The third amendment to the bill, of course, would simply strike from the bill this withholding tax arrangement that we heard discussed a moment ago by the gentleman from Massachusetts, whom I respect very much but with whom no one could differ more than I. I have had some experience during my lifetime as head of some small corporations, and in connection with some financial institutions. In my opinion, and I think also that of almost every tax expert who has studied this withholding section of the tax bill, against which so many Americans have protested, and rightly so, is a legislative monstrosity which simply cannot be made to work effectively. It will create all sorts of injustices and hardships on corporations and financial institutions throughout America, which would be required to withhold these taxes on dividends and interest and send them in to the Federal Government. In other words, it is another one of these arrangements where the Government says to private corporations and private financial institutions—"just go out and employ your own help to collect these taxes for the Federal Government, pay their salaries, and then pay taxes on the salaries of those you must employ to do the job the Federal Government should do—collect Federal taxes."

Now, the question arises in the minds of all of us—is that necessary? Is that the best way to handle this situation to make sure every person who should pay taxes on dividends or interest income, will do so?

Let me remind you that we have an Internal Revenue form, No. 1099, every corporation and every financial institution is required to fill out in triplicate, keeping one copy and filing two copies with the Internal Revenue Service. What does form No. 1099 do? It provides, first of all, that you must give the name and the address of the individual affected by whatever income may be reported on the form. You also must give the social security number or its Internal Revenue Service number of each person. For example, let it be John A. Jones. First of all, you fill out on the form giving his name, his address, and social security number or Internal Revenue Service number. Then you put down whether he has received any pay for work, and whether any W-2 forms for salaries and wages have been filed for him. Then next, you report any income he may have received from

dividends, over \$10, in each year. Next comes a report of any rentals paid to this individual, and any amounts paid him over \$600, for services such as trucking or anything else. You furnish all that information and it goes where? It goes to the Internal Revenue Service. All in the world they have to do is just to put such a report over in Mr. John A. Jones' file, whether he receives only one dividend from one corporation, or 100 dividends from 100 corporations. And if he does not pay his tax thereon, there is the evidence and there is the information the Government can readily and easily use, to collect taxes due, at much lower cost than by this other method provided in this pending bill.

Let me say to some of my friends from Ohio who ask, How does that work? We have in my home State an intangible tax that requires all Ohioans to pay a 5 percent tax, almost like a State income tax, on dividends and interest received. There we have to fill out another form almost identical to Federal form No. 1099 except that it is State form No. 939, and send it to the State department of taxation at Columbus, showing, as you gentlemen from Ohio know, the dividends that have been paid to any Ohio individual by any corporation. From Columbus it is distributed to the 88 county auditors in the State of Ohio. They immediately check back on the intangible tax returns filed with them by the individuals concerned. If one has not paid his intangible tax on these dividends, he is immediately notified to come in and explain and, believe it or not, through that very simple system which the Federal Government can also use, if it wishes to, we are collecting better than 99 percent of all intangible taxes due in the State of Ohio. The only ones who escape are the one who die during the interim period before the returns get back to the county auditor and he can call them in.

Let me go ahead for just a minute or two, for I promised to say a few words about these amendments.

Amendment No. 1 would strike section 2 of the bill, H.R. 19650, providing for a so-called investment credit. The amendment would substitute the language of H.R. 10906. The substitute would add two new provisions to the Internal Revenue Code.

We have a provision permitting additional accelerated depreciation not to exceed 20 percent more than the depreciation to which the taxpayer presently is entitled.

Instead of giving a windfall to just a few rich investors, as provided in the pending bill, it would give all concerns a 20-percent reduction in their present depreciation allowances, according to what they may be entitled to. It would apply to the same category of assets that would be eligible for the investment credit. It differs from investment credit in that there would be no double deduction. Under this bill you can deduct first your tax credit and next your depreciation allowance for tax purposes. The taxpayer would not be permitted, under the amendment, to deduct more than 100 percent of his cost over the full period of depreciation deductions.

The second provision would permit retail and distribution trades to reduce their closing inventories by an amount not to exceed 20 percent of the first \$100,000 in inventory. The effect of this provision is to give the small retailer and distributor a cushion against inventory losses and obsolescence. It balances the relief granted to this segment of the economy with the relief granted to a different segment of the economy in the depreciation provision. The effect of the inventory adjustment will be that the small businessman can set aside out of profits an amount not to exceed \$20,000 which is reinvested in inventory.

The continuing cost of adding these two provisions to the Internal Revenue Code has been estimated at about one-half of the cost of investment tax credit arrangement alone.

Let me say that the latest information I have received this morning from the highest tax authority in this country, in my opinion, on this tax bill, is to the effect that the new amendments to the measure to be offered by the Ways and Means Committee will cost the Treasury at least \$1 billion this coming year. So this bill, if adopted as it is, will not be a tax raising bill but will be a tax reduction measure. For the benefit of whom? For a few who have ready money to invest. I am informed, from reliable sources, that one corporation in America alone, under the provisions of the original bill as brought here and as now before you, could gain about \$100 million, which is a pretty nice windfall for any concern.

This amendment proposed here would take care of everyone, whether a small industry, a small businessman, a small manufacturer, and would help do away with obsolescence and bring about greater investments more rapidly, whether in the small community or the large city.

Amendment No. 2 proposes to strike section 13 of the bill and to substitute the language of H.R. 10803, which is simply nothing more or less than the proviso on foreign corporation earnings that was written by the Joint Committee on Internal Revenue Taxation, was adopted unanimously, I believe, by the House Committee on Ways and Means, and then changed at the last minute when there was a lot of monkey-doodling going on on this bill to try to make it a little more palatable for the people who might be prevailed upon to vote for it.

Finally, the last amendment, of course, would strike out entirely the withholding tax section of the pending bill.

I hope that when the vote comes on the previous question on the adoption of this gag rule that it will be voted down, so we may be able to immediately offer the substitute bill I have mentioned above, as an amendment to the original rule, and call for a prompt vote thereon without continued debate.

Mr. Speaker, I reserve the balance of my time.

Mr. O'NEILL. Mr. Speaker, I yield 10 minutes to the gentleman from Oklahoma [Mr. ALBERT].

Mr. ALBERT. Mr. Speaker, if this rule is adopted, and I hope it will be

adopted, we will have before us one of the most important bills in the legislative program of the President of the United States. This revenue bill, which the Committee on Ways and Means has been considering for months, embraces some 20 sections and 240 pages. It is one of the most important measures to come before the Congress in a number of years.

The committee has brought this bill to the floor of the House after lengthy consideration, after analysis of its effects on the Treasury and the economy of the country, with a request for a closed rule, which the Committee on Rules has granted. Under the rule 8 hours of general debate will be in order. Amendments offered by the Committee on Ways and Means will be in order, and a motion to recommit, controlled by the minority, will be in order prior to final passage.

The rule under which this resolution is made in order is the historic one under which complicated tax proposals have been brought to this House throughout the years. The right of the Committee on Ways and Means to offer amendments has been recognized in every rule of this kind that I have been able to find anywhere in the CONGRESSIONAL RECORD over the past 30 years. This is the normal, the typical closed rule.

Under this rule the rights of the minority are fully protected. The minority has the motion to recommit. All of the proposals discussed at length by the gentleman from Ohio can be contained in the motion to recommit.

The issue here, first, is whether these amendments, all of which the gentleman from Ohio has advocated, all of which have been coordinated by those who favor them, should be considered in bulk in a responsible manner, or whether the House should single-shot these amendments, winding up possibly by adopting some amendment that would throw the bill out of balance and not adopting others. The question here is, Shall we have responsible legislation, responsible revenue legislation, or shall we have single-shot legislation which may destroy the fiscal balance of this bill?

The proposed procedure is irresponsibility in its most irresponsible form. Either we accept these amendments, debate them on their merits, and offer them under the motion to recommit, or we take a course of irresponsibility.

Mr. Speaker, the right of the minority is protected and the right of the individual is protected by the rules, the customs, and the traditions of this House. If we do not follow the regular customs and procedures of this House in consideration of legislation of this kind, or of any kind, the majority could run roughshod over the rights of the minority or over the rights of the individual.

The rules, regulations, and the time-tested procedures of this House are the greatest bulwark that individual Members and minority Members have against arbitrary action.

The procedure made in order by the pending resolution is in accord with the time-honored custom of the House. It has long had a wide measure of bipartisan support. During the adminis-

tration of President Eisenhower and previously the Democratic leadership cooperated on measure after measure with the desires of the Republican leadership to bring out important revenue bills under closed rules. As far back as the 80th Congress when the Tax Reduction Act of 1947 was before the House a resolution providing for a closed rule had strong support from the Democratic leadership and membership.

In the 83d Congress three important tax bills were considered under rules similar to the one before the House at this time.

H.R. 5898, to extend the excess-profits tax, was considered under the provisions of House Resolution 326 which did not permit amendments from the floor and which was passed on July 10, 1953, without a rollcall vote.

House Resolution 4165 which prohibited all amendments except those offered by direction of the Committee on Ways and Means and which was agreed to on March 10, 1954 made in order H.R. 8224, a bill to reduce excise taxes.

House Resolution 473 which prohibited all amendments except those offered by the Committee on Ways and Means and which made in order H.R. 8300 to revise the Internal Revenue laws of the United States, was adopted March 17, 1954.

In the 84th Congress, House Resolution 153, which prohibited amendments except those offered by the direction of the Committee on Ways and Means and which made in order H.R. 4259 to provide a 1-year extension of corporate normal tax rate and of certain excise tax rates and to provide a \$20 credit against the individual income tax for each personal exemption, was adopted February 24, 1955.

In the 85th Congress three amendments all of which prohibited amendments except those offered by the direction of the Committee on Ways and Means, namely, House Resolution 270, which made in order H.R. 7125 to make technical changes in the Federal excise tax laws; House Resolution 586, which made in order H.R. 12695 to provide a 1-year extension of the corporate normal-tax rate and certain existing excise tax rates; and House Resolution 447, which made in order H.R. 8381, the Technical Amendments Act of 1957, were passed without rollcall votes.

In the 86th Congress the following bills were brought up under similar rules, all of which rules were passed without rollcall votes:

H.R. 4245, taxation of income of life insurance companies.

H.R. 7523 to provide a 1-year extension of existing corporate normal-tax rate and of certain excise-tax rates.

H.R. 9662 to make technical revisions in the income tax provision of the Internal Revenue Code of 1944 relating to estates, trusts, and partnerships.

The rule to which the gentleman from Ohio referred that came out with the revenue bill in 1941 was reported under entirely different circumstances. It came out with the recommendation by the Committee on Ways and Means that

the House be permitted to vote separately on the amendments in question. It also came out with a rule that made provision for such separate consideration in the House.

To the Republican Members of the House let me say that if you take the course of action suggested by the gentleman from Ohio you are going to set a precedent which might come back to haunt you. You have the same interest in the stability of the procedures of this House as the majority Members of the House have.

Now, to my Democratic friends let me say that this is a procedural matter. There is just one issue and that is whether the management of this bill is going to be taken away from the Democrats and given to the Republicans. The rule which the gentleman from Ohio advocates, which he says he will offer as an amendment to the rule if the previous question is voted down, by his own admission, is not an open rule; it is a closed rule under the exclusive control of the gentleman from Ohio [Mr. Brown], and nobody else.

Mr. FEIGHAN. Mr. Speaker, will the gentleman yield?

Mr. ALBERT. I yield to the gentleman from Ohio.

Mr. FEIGHAN. If the motion offered by the gentleman from Ohio [Mr. Brown] is carried, that would still permit any member of the Committee on Ways and Means to offer any amendment he so desired, would it not?

Mr. ALBERT. That is true, but it also would gag other Members of the House with respect to amendments other than those offered by the Committee on Ways and Means and those made in order by the Brown amendment to the rule.

Mr. FEIGHAN. No one except a member of the Committee on Ways and Means can offer an amendment, anyway.

Mr. ALBERT. That is true under either rule. The whole question here is whether we should single-shot these amendments and throw this bill out of balance, if we adopt one of the provisions and do not adopt the others, or whether we should consider the merits of the two proposals; that is, the one embraced in the bill and the one which would be embraced in the bill should the motion to recommit be adopted.

That is the real issue.

Mr. Speaker, the generosity of the gentleman from Ohio [Mr. Brown] overwhelms me. Whence this new-found concern over the right of Members to express themselves on legislation? Is this the same distinguished member of the Committee on Rules who for two decades has been blocking consideration of bills by refusing to grant rules on some of the most important legislative proposals submitted to the House by three Democratic Presidents?

Mr. Speaker, talk about Greeks bearing gifts. If we buy this package we will buy a pig in a poke.

The Committee on Ways and Means is entitled to present its case. This important program of the President of the United States is entitled to be considered

on the floor of the House on its merits. This maneuver to thwart orderly procedure and accepted parliamentary practice should be voted down. I urge the Members of the House to support the previous question—to adopt the resolution and to proceed with the consideration of this bill under general debate.

Mr. O'NEILL. Mr. Speaker, I yield such time as he may consume to the gentleman from Virginia [Mr. SMITH].

Mr. SMITH of Virginia. Mr. Speaker, I do not propose to discuss the merits of this piece of legislation. But I think I should say this, as Chairman of the Rules Committee from which this rule was reported. A long experience on that committee with rules of this kind has led me to the very reluctant conclusion, and I have followed that policy for many years, that it is just a practical impossibility to do a good job in handling a tax bill under an open rule. Then, if you try to do what we are trying to do here this morning, substitute other legislation which has not been given serious consideration and which none of us understand—at least I do not—I think we could get in a very serious condition. I think we should adopt the closed rule, which has been the policy of this Congress as long as I can remember. Now, I remember the first term of Congress when I came here. We Democrats had won control of the House after a great many years of Republican control. We were all fired up and pepped up to change things around. I remember that in my first session here the late Charlie Crisp of Georgia, who was Chairman of the Ways and Means Committee, was going to have things democratic, and we all wanted to have things democratic. He brought in a tax bill with an open rule. It was a sales tax bill. We scrambled around here for about a week or 10 days with that bill and things got into such a state of confusion that nobody knew what he was doing and it went back to the committee.

I think nobody regrets more than I do having to bring in a closed rule here. I do a lot of fussing about it, but when the chips are down I think the only feasible and practical way we can operate is under a closed rule.

Mr. O'NEILL. Mr. Speaker, I yield 3 minutes to the gentleman from Louisiana [Mr. BOGGS].

Mr. BOGGS. Mr. Speaker, I hope and believe the Members will have the good judgment to vote down the suggestion of the gentleman from Ohio and permit us to debate this legislation under the rule approved by the Rules Committee and supported by the distinguished gentleman from Virginia [Mr. SMITH]. Also, I would hope that after we have voted up the rule, the Members who have some questions in their minds about this proposed legislation will stay here at least until the Chairman of our great committee, the gentleman from Arkansas [Mr. MILLS], has concluded the detailed presentation of this legislation.

The attack made by the gentleman from Ohio in his proposal is an attack upon the fundamental principles involved in the legislation. This legislation has not been considered for a short

period of time. It has been given, to my knowledge, the fullest, the most complete consideration that I have ever seen accorded any proposal before the great Committee on Ways and Means.

The attack being made here in the investment credit proposal is a fundamental attack. But let me say this, and I address this to all Members of the House, but to my Democratic colleagues—many of you in your campaigns have had to face the contention that the party of which you are a member is against business and does not believe in the growth and promotion of the free enterprise system.

If there ever was a proposal which is designed to increase employment, to create new jobs, and to give credit to business expansion and growth, it is the proposal now before us.

I have listened to the attacks made on it as being favorable to big business and not making concessions here, there, and elsewhere. I have never been one of those who have been against business, whether it be big, large, middle size, or indifferent. I am happy to see that this legislation recognizes that there is a need for the expansion of investment in the United States. Soon we will be considering legislation dealing with the European Common Market, which has had a phenomenal growth because of new investment in that area of the world.

I would hope, Mr. Speaker, that we will approve the rule as presented by the Rules Committee, and that the Members of this body on both sides will stay here and listen to the presentation of the chairman of our committee, which will be made as soon as the vote is concluded on the rule.

Mr. BROWN. Mr. Speaker, I yield 3 minutes to the gentleman from Wisconsin [Mr. BYRNES].

Mr. BYRNES of Wisconsin. Mr. Speaker, I think the distinguished majority leader was considerably carried away when he charged that the action that is proposed to be taken here by the gentleman from Ohio in providing us with a limited rule rather than a strict gag rule was irresponsible. Is it—and maybe that is the issue before us—is it irresponsible to give you as an individual Member of Congress a right to an alternative on three sections of this bill that are controversial? Is it irresponsible to let the House attempt to work its will? As far as I am concerned it is a mark of responsibility—that we make a choice and not to be limited exclusively to what 13 or 15 members of the Committee on Ways and Means may present to us. We are a House of Representatives and we have the right to work our will.

To hear the majority leader, you would also think that this is something that had never been done before. As was pointed out by the gentleman from Ohio, it was done in 1941 when there was a limited rule. The right to consider three amendments will not create chaos. How silly can you be? We proposed three specific amendments that will be offered. This is not something that is pulled out of thin air and some-

thing that you have to wait and see what somebody schemes up. The two substitutes which will be proposed for two sections have been introduced in bill form. They were both before the Committee on Ways and Means on several occasions and were discussed in that committee. There is nothing new or complex about it from that standpoint.

I was a little surprised by the remarks of the chairman of the Committee on Rules, because if you would just go back to March 15 of this year, just a week or so ago, he said then, and I quote from the RECORD on page 3907:

I do not think we would violate the necessary part of the closed rule if we would permit, in the House, a vote on a specific proposition.

That is what we are asking here—votes on three specific propositions, and that is all. He also said:

What harm could it do to the logic of the closed rule theory if the House were permitted to say on the one proposition, "We want it" or "We do not want it"?

That is the issue we want to put before you as an individual item on the withholding proposition. Do you want it or do you not want it? The question here is—will you, and will this House, be able to work its will on the three provisions of this bill, on which there is divided opinion?

Will you be able to choose between the handout, the \$1½-billion loophole, the windfall to business as proposed by the bill, or the alternative of depreciation reform as contained in bill H.R. 10906?

Will you be able to choose between the provisions of the bill which will penalize American enterprise operating abroad as contained in the committee bill or the alternative as contained in bill H.R. 10803 which is limited to preventing true tax avoidance?

Will you be able to choose between imposing withholding on dividends and interest as proposed by the bill or the alternative of striking this provision from the bill?

That is the question you will decide when you vote on ordering the previous question. If you vote "Yes" on that motion you will deny yourself the opportunity to listen to the debate and then vote on the merits of these three alternatives.

Remember that if you vote "Yes" on this motion you will not be able to say to your people, "I was against the tax bonanza to business but I had no choice. I had to take the whole bill or nothing."

If you vote "yes" on the previous question you will not be able to tell your people, "I was against withholding but I had no choice. I had to take the bill as a whole or nothing."

If you vote "yes" on the previous question you will not be able to tell your people, "I was against putting American business abroad at a disadvantage but I had no alternative. I had to take the whole bill or nothing."

If you vote "yes" on the previous question you will vote to gag yourself. You vote to deny yourself an opportunity to have a voice in determining what will be done with respect to these three very important items in the bill.

I trust you will vote "no" on ordering the previous question. We can then have a rule which will permit you and the House to work its will on these matters.

The SPEAKER. The gentleman from Massachusetts [Mr. O'NEILL] is recognized.

Mr. O'NEILL. Mr. Speaker, with regard to the parliamentary situation at the present time, I remind my colleagues that this closed rule was reported by the unanimous vote of the Democratic majority of those present and it is by the action of the committee that the gentleman from Ohio at the present time is precluded from offering his amendment to the resolution which has been reported to the House for its consideration. If the previous question is voted down, then the gentleman from Ohio will be in control of the time of the House for 1 hour so that he may offer the closed rule which he favors. The difference between the majority and the minority in this instance is that the minority is opposed to the closed rule offered by the majority party and would like to offer their own closed rule. The minority does not propose an open rule which would enable you to vote on the issue of oil depletion allowances or, for example, where you could vote on the question of the excise tax. No; they take the rule they are interested in themselves and they offer you their version of a closed rule.

I hope the Members on this side will follow along with the leaders.

Mr. Speaker, I move the previous question on the resolution.

Mr. BROWN. Mr. Speaker, on this motion I ask for the yeas and nays.

The yeas and nays were ordered.

The SPEAKER. The question is on the adoption of the previous question.

Mr. BROWN. Mr. Speaker, a parliamentary inquiry.

The SPEAKER. The gentleman will state his parliamentary inquiry.

Mr. BROWN. Am I correct in the assumption that a "no" vote would be against the previous question and therefore for an open rule?

The SPEAKER. The Chair thinks that is well known by every Member.

Mr. BROWN. I hope every Member does know it.

Mr. O'NEILL. As to the statement made by the gentleman from Ohio, he said a "no" vote meant an open rule. A "no" vote means a closed rule as proposed by the minority.

The SPEAKER. The Chair will again state the motion. The question before the House is the adoption of the previous question.

The question was taken and there were—yeas 224, nays 184, not voting 28, as follows:

[Roll No. 47]

YEAS—224

Addabbo	Beckworth	Burleson
Addonizio	Bennett, Fla.	Carey
Albert	Blatnik	Casey
Alexander	Boggs	Celler
Alford	Boland	Chelf
Anfuso	Bolling	Clark
Ashley	Bonner	Coad
Ashmore	Boykin	Cohelan
Aspinall	Brademas	Cook
Bailey	Breeding	Corman
Baring	Buckley	Daddario
Barrett	Burke, Ky.	Daniels
Bass, Tenn.	Burke, Mass.	Davis, John W.

Davis, Tenn.	Jones, Mo.	Poage
Dawson	Karsten	Powell
Delaney	Karth	Price
Dent	Kastenmeier	Pucinski
Denton	Kee	Purcell
Diggs	Kelly	Randall
Dingell	Keogh	Reuss
Donohue	Kilgore	Rhodes, Pa.
Dorn	King, Calif.	Rivers, Alaska
Dowdy	King, Utah	Rivers, S.C.
Downing	Kirwan	Roberts, Tex.
Doyle	Kitchin	Rodino
Dulski	Kluczynski	Rogers, Colo.
Edmondson	Kornegay	Rogers, Fla.
Elliott	Landrum	Rogers, Tex.
Everett	Lankford	Rooney
Evins	Lennon	Roosevelt
Farbstein	Lesinski	Rosenthal
Finnegan	Libonati	Rostenkowski
Fisher	Loser	Roush
Flood	McDowell	Rutherford
Flynt	McFall	Ryan, Mich.
Fogarty	McMillan	Ryan, N.Y.
Fountain	McSweeney	St. Germain
Frazier	Macdonald	Santangelo
Friedel	Mack	Saund
Gallagher	Madden	Scott
Garmatz	Magnuson	Shelley
Gary	Mahon	Shipley
Gathings	Marshall	Sikes
Gilbert	Matthews	Sisk
Gonzalez	Miller, Clem	Slack
Granahan	Miller,	Smith, Va.
Grant	George P.	Spence
Gray	Mills	Staggers
Green, Oreg.	Moeller	Steed
Green, Pa.	Montoya	Stephens
Griffiths	Moorhead, Pa.	Stratton
Hagen, Calif.	Morgan	Stubblefield
Hansen	Morris	Sullivan
Harding	Morrison	Taylor
Hardy	Moss	Teague, Tex.
Harris	Moulder	Thomas
Harrison, Va.	Murphy	Thompson, La.
Healey	Murray	Thompson, N.J.
Hebert	Natcher	Thompson, Tex.
Hechler	Nedzi	Thornberry
Henderson	Nix	Toll
Herlong	Norrell	Trimble
Hollifield	O'Brien, Ill.	Udall, Morris K.
Holland	O'Brien, N.Y.	Ullman
Huddleston	O'Hara, Ill.	Vinson
Hull	O'Hara, Mich.	Waggonner
Ichord, Mo.	Olsen	Watts
Inouye	O'Neill	Whitener
Jarman	Passman	Wickersham
Jennings	Patman	Willis
Joelson	Perkins	Wright
Johnson, Calif.	Post	Yates
Johnson, Md.	Philbin	Young
Johnson, Wis.	Pike	Zablocki
Jones Ala.	Pilcher	Zelenko

NAYS—184

Abbott	Corbett	Harvey, Ind.
Abernethy	Cramer	Harvey, Mich.
Adair	Cunningham	Hays
Alger	Curtin	Hemphill
Andersen, Minn.	Curtis, Mass.	Hiestand
Anderson, Ill.	Curtis, Mo.	Hoeven
Arends	Dague	Hoffman, Ill.
Ashbrook	Davis,	Horan
Auchincloss	James C.	Hosmer
Avery	Derounian	Jensen
Ayres	Derwinski	Johansen
Baker	Devine	Jonas
Barclay	Dole	Judd
Barry	Dominick	Kearns
Bass, N.H.	Dooley	Keith
Battin	Durno	Kilburn
Becker	Dwyer	King, N.Y.
Beermann	Ellsworth	Knox
Belcher	Fallon	Kowalski
Bell	Feighan	Kunkel
Berry	Fenton	Kyl
Betts	Findley	Laird
Bolton	Fino	Langen
Bow	Ford	Latta
Bray	Forrester	Lindsay
Brewster	Frelinghuysen	Lipscomb
Bromwell	Fulton	McCulloch
Broomfield	Garland	McDonough
Brown	Gavin	McIntire
Broyhill	Glaimo	McVey
Bruce	Glenn	MacGregor
Byrnes, Wis.	Goodell	Mailliard
Cahill	Goodling	Martin, Mass.
Cederberg	Griffin	Martin, Nebr.
Chamberlain	Gross	Mason
Chenoweth	Gubser	Mathias
Chipperfield	Haley	May
Church	Hall	Meador
Clancy	Halleck	Merrow
Collier	Halpern	Michel
Conte	Harrison, Wyo.	Milliken
	Harsha	Minshall

Monagan	Riehlman	Teague, Calif.
Moore	Robison	Thomson, Wis.
Moorehead,	Roudebush	Tuck
Ohio	Roussetot	Utt
Morse	St. George	Vanik
Mosher	Saylor	Van Pelt
Multer	Schadeberg	Van Zandt
Nelsen	Schenck	Wallhauser
Norblad	Schneebeli	Weaver
O'Konski	Schweiker	Weiss
Osmers	Schwengel	Westland
Ostertag	Scranton	Whalley
Pelly	Seely-Brown	Wharton
Pillion	Shriver	Whitten
Pirnie	Sibal	Widnall
Poff	Siler	Williams
Quile	Smith, Calif.	Wilson, Calif.
Ray	Smith, Iowa	Winstead
Reece	Springer	Younger
Reifel	Stafford	
Rhodes, Ariz.	Taber	

NOT VOTING—28

Andrews	Fascell	Scherer
Bates	Hagan, Ga.	Selden
Bennett, Mich.	Hoffman, Mich.	Sheppard
Blitch	Lane	Short
Brooks	Miller, N.Y.	Smith, Miss.
Byrne, Pa.	Nygaard	Tollefson
Cannon	Peterson	Tupper
Colmer	Rains	Walter
Cooley	Roberts, Ala.	Wilson, Ind.

So the previous question was ordered. The Clerk announced the following pairs:

On this vote:

Mr. Brooks for, with Mr. Colmer against.
Mr. Cooley for, with Mr. Walter against.
Mr. Byrne of Pennsylvania for, with Mr. Tupper against.

Mr. Lane for, with Mr. Bates against.
Mr. Sheppard for, with Mr. Nygaard against.

Mr. Hagan of Georgia for, with Mr. Short against.

Mr. Rains for, with Mr. Wilson of Indiana against.

Mr. Roberts for, with Mr. Scherer against.
Mrs. Blitch for, with Mr. Tollefson against.

Until further notice:

Mr. Andrews with Mr. Hoffman of Michigan.

Mr. Selden with Mr. Bennett of Michigan.

Mr. PASSMAN changed his vote from "nay" to "yea."

The result of the vote was announced as above recorded.

The SPEAKER. The question is on the adoption of the resolution.

Mr. BOGGS. Mr. Speaker, on that I ask for the yeas and nays.

The yeas and nays were ordered.

The question was taken and there were yeas 234, nays 172, not voting 30, as follows:

[Roll No. 48]

YEAS—234

Abbott	Burke, Mass.	Doyle
Addabbo	Burleson	Edmondson
Addonizio	Byrnes, Wis.	Elliott
Albert	Carey	Everett
Alexander	Casey	Evins
Alford	Celler	Farbstein
Anfuso	Chelf	Finnegan
Ashley	Clark	Fisher
Aspinall	Coad	Flood
Avery	Cohelan	Flynt
Ayres	Corbett	Fogarty
Bailey	Corman	Fountain
Baring	Curtis, Mass.	Frazier
Barrett	Daddario	Friedel
Bass, Tenn.	Daniels	Gallagher
Beckworth	Davis, John W.	Garmatz
Bennett, Fla.	Davis, Tenn.	Gary
Blatnik	Dawson	Gathings
Boggs	Delaney	Gavin
Boland	Dent	Gilbert
Bolling	Denton	Gonzalez
Bonner	Diggs	Granahan
Boykin	Dingell	Grant
Brademas	Donohue	Gray
Breeding	Dorn	Green, Oreg.
Buckley	Dowdy	Griffiths
Burke, Ky.	Downing	Hagan, Ga.

Halleck	Madden	Rogers, Tex.
Hansen	Magnuson	Rooney
Harding	Mahon	Roosevelt
Hardy	Marshall	Rosenthal
Harris	Mason	Rostenkowski
Harrison, Va.	Matthews	Roush
Healey	Merrow	Rutherford
Hébert	Miller, Clem	Ryan, Mich.
Hechler	Miller,	Ryan, N.Y.
Henderson	George P.	St. Germain
Herlong	Mills	Santangelo
Holifield	Moeller	Saund
Holland	Montoya	Saylor
Huddleston	Moorhead, Pa.	Scott
Hull	Morgan	Shelley
Ichord, Mo.	Morris	Shipley
Inouye	Morrison	Sikes
Jarman	Moss	Sisk
Jennings	Multer	Slack
Joelson	Murphy	Smith, Iowa
Johnson, Calif.	Murray	Smith, Va.
Johnson, Md.	Natcher	Spence
Johnson, Wis.	Nedzi	Staggers
Jones, Ala.	Nix	Steed
Jones, Mo.	Norrell	Stephens
Judd	O'Brien, Ill.	Stratton
Karsten	O'Brien, N.Y.	Stubblefield
Karth	O'Hara, Ill.	Sullivan
Kastenmeier	O'Hara, Mich.	Taylor
Kearns	Olsen	Teague, Tex.
Kee	O'Neill	Thomas
Kelly	Passman	Thompson, La.
Keogh	Patman	Thompson, N.J.
Kilgore	Perkins	Thompson, Tex.
King, Calif.	Pfost	Thornberry
King, Utah	Philbin	Toll
Kirwan	Pike	Trimble
Kitchin	Pilcher	Udall, Morris K.
Kluczynski	Poage	Ullman
Kornegay	Powell	Vinson
Landrum	Price	Waggonner
Lankford	Pucinski	Watts
Lennon	Purcell	Whitener
Lesinski	Randall	Wickersham
Libonati	Reuss	Willis
Loser	Rhodes, Pa.	Wright
McDowell	Rivers, Alaska	Yates
McFall	Rivers, S.C.	Young
McMillan	Roberts, Tex.	Zablocki
McSweeney	Rodino	Zelenko
Macdonald	Rogers, Colo.	
Mack	Rogers, Fla.	

NAYS—172

Abernethy	Dooley	Lipscomb
Adair	Dulski	McCulloch
Alger	Durno	McDonough
Andersen,	Dwyer	McIntire
Minn.	Ellsworth	McVey
Anderson, Ill.	Fallon	MacGregor
Arends	Feighan	Mailliard
Ashbrook	Fenton	Martin, Mass.
Auchincloss	Findley	Martin, Nebr.
Baker	Fino	Mathias
Baldwin	Ford	Meador
Barry	Forrester	Michel
Bass, N.H.	Frelinghuysen	Miller, N.Y.
Battin	Fulton	Milliken
Becker	Garland	Minshall
Beermann	Glaimo	Monagan
Belcher	Glenn	Moore
Bell	Goodell	Moorehead,
Berry	Goodling	Ohio
Betts	Griffin	Morse
Bolton	Gross	Mosher
Bow	Gubser	Nelsen
Bray	Hagen, Calif.	Norblad
Brewster	Haley	O'Konski
Broomwell	Hall	Osmer
Broomfield	Halpern	Ostertag
Brown	Harrison, Wyo.	Pelly
Broyhill	Harsha	Pillion
Bruce	Harvey, Ind.	Pirnie
Cahill	Harvey, Mich.	Poff
Cederberg	Hays	Quie
Chamberlain	Hemphill	Ray
Chenoweth	Hiestand	Reece
Chipewick	Hoeven	Reifel
Church	Hoffman, Ill.	Rhodes, Ariz.
Clancy	Horan	Riehlman
Collier	Hosmer	Robison
Conte	Jensen	Roudebush
Cook	Johansen	Rousset
Cramer	Jonas	St. George
Cunningham	Keith	Schadeberg
Curtin	Kilburn	Schenck
Curtis, Mo.	King, N.Y.	Schneebell
Dague	Knox	Schweiker
Davis	Kowalski	Schwengel
James C.	Kunkel	Scranton
Derounian	Kyl	Seely-Brown
Derwinski	Laird	Shriver
Devine	Langen	Sibal
Dole	Latta	Siler
Dominick	Lindsay	Smith, Calif.

Springer	Van Pelt	Whitten
Stafford	Van Zandt	Widnall
Taber	Wallhauser	Williams
Teague, Calif.	Weaver	Wilson, Calif.
Thomson, Wis.	Wels	Winstead
Tuck	Westland	Younger
Utt	Whalley	
Vanik	Wharton	

NOT VOTING—30

Andrews	Fascell	Scherer
Ashmore	Green, Pa.	Selden
Bates	Hoffman, Mich.	Sheppard
Bennett, Mich.	Lane	Short
Blitch	May	Smith, Miss.
Brooks	Moulder	Tollefson
Byrne, Pa.	Nygaard	Tupper
Cannon	Peterson	Walter
Colmer	Rains	Wilson, Ind.
Cooley	Roberts, Ala.	

So the resolution was agreed to.

The Clerk announced the following pairs:

On this vote:

Mr. Brooks for, with Mr. Colmer against.
Mr. Cooley for, with Mr. Walter against.
Mr. Byrne of Pennsylvania for, with Mr. Tupper against.
Mr. Lane for, with Mr. Bates against.
Mr. Sheppard for, with Mr. Nygaard against.

Mr. Green of Pennsylvania for, with Mr. Short against.
Mr. Rains for, with Mr. Wilson of Indiana against.

Mr. Roberts for, with Mr. Scherer against.
Mrs. Blitch for, with Mr. Tollefson against.

Until further notice:

Mr. Andrews with Mr. Hoffman of Michigan.

Mr. Selden with Mr. Bennett of Michigan.

Mr. FENTON and Mr. FOGARTY changed their votes from "yea" to "nay."

The result of the vote was announced as above recorded.

Mr. KEARNS. Mr. Speaker, a parliamentary inquiry.

The SPEAKER. The gentleman will state it.

Mr. KEARNS. Mr. Speaker, it is my understanding that we go into how many hours of debate?

The SPEAKER. In response to the parliamentary inquiry, the rule provides for 8 hours of debate.

Mr. KEARNS. I thank the Speaker.

REVENUE ACT OF 1962

Mr. MILLS. Mr. Speaker, I move that the House resolve itself into the Committee of the Whole House on the State of the Union for the consideration of the bill (H.R. 10650) to amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes.

The SPEAKER. The question is on the motion offered by the gentleman from Arkansas.

The motion was agreed to.

Accordingly, the House resolved itself into the Committee of the Whole House on the State of the Union for the consideration of the bill H.R. 10650, with Mr. ROOSEVELT in the chair.

The Clerk read the title of the bill.

By unanimous consent, the first reading of the bill was dispensed with.

The CHAIRMAN. Under the rule, the gentleman from Arkansas [Mr. MILLS] is recognized for 4 hours and the gentleman from Illinois [Mr. MASON] is recognized for 4 hours. The Chair recognizes

the gentleman from Arkansas [Mr. MILLS].

Mr. MILLS. Mr. Chairman, I yield myself 40 minutes.

Mr. Chairman, we are beginning consideration of what I consider to be the most important tax proposal considered by the Congress in many years and certainly since the Internal Revenue Code of 1954. In many respects the proposal now pending before the Committee of the Whole involves more policy decisions than the Internal Revenue Code changes of 1954 involved, for in that instance we were primarily concerned with recodification of the law.

Today in this bill we are concerned in 20 of the 21 sections with certain fundamental policy changes in the provisions of existing law, many of which have been in effect since the inception of our income tax laws, following the constitutional amendment of 1913.

Mr. Chairman, there are far too many detailed, involved provisions in this bill for any one member of the committee to cover all of the various subjects within anything like a reasonable time. For that reason, it shall be my purpose today to discuss very briefly certain of the provisions and to devote more detail to other provisions about which there seems to be more question than with respect to others.

Mr. Chairman, there are two provisions of the bill, the second and third sections, the investment credit, and the legislative expense provisions, that serve to reduce revenues.

There are six sections of the bill that serve to provide additional revenues from sources within the United States. There are 12 sections of the bill that deal with the treatment of foreign income including that of foreign subsidiaries owned by American individuals or corporations.

Mr. Chairman, the provisions of the bill which produce revenue, will produce, according to the estimates of the Treasury, \$1,295 million additional revenue. You will find a breakdown of those estimates in the early part of the committee report on this bill.

Mr. Chairman, the investment credit, as it will be modified through the adoption of the amendments that the committee will offer during the course of the reading of the bill, involves a loss in a full year's operation of \$1,175 million. The net effect of the bill, therefore, on the basis of the estimates of Treasury, is a pickup of \$120 million, not taking into consideration any impetus that may be given the economy through the adoption of the investment provision.

There has been on the part of some Members some degree of criticism of the action of the committee in changing the investment rate. When the bill was reported the committee faced some 4 or 5 weeks of hearings on the trade program. We reported the bill before we had a firm estimate of the revenue effects of the bill. When those effects were presented to us in firm form, I was concerned because the investment credit provision was losing \$1,800 million and we were picking up as an offset only \$1,295 million in a full year of operation, according to Treasury's estimate. I did

not want a bill that was not in balance revenue-wise.

Mr. Chairman, when the President asked for this program last year he proposed a balanced tax bill as to revenue effect. He was right then; he is right now. The committee would have been wrong, in my opinion, in asking the House to accept a bill that did not meet the test of revenues being in balance.

Mr. Chairman, this bill with the amendments that will be offered on the part of the committee reducing the investment credit rate and ceiling will not only be in balance in its first full year of operation, but further, this bill will bring in a plus of revenue of \$120 million in its first full year of operation.

There has been some criticism by some members of the committee because the bill will have some adverse effect, they say, upon the revenues that will be developed by the Government in fiscal year 1963 which begins, of course, on July 1 of this year.

Mr. Chairman, the Secretary of the Treasury took into consideration in developing estimates for the President's budget an effect of the investment credit of \$1,500 million on revenues in fiscal year 1963. That was taken into consideration in determining the estimates of revenue. It cannot be said—it cannot be proven by anyone—that the enactment of this program will serve to eliminate the possibility of a balanced budget in fiscal year 1963. The committee has reduced the effect of the investment credit in its amendments that it will ask you to accept from \$1.8 billion to \$1.175 billion. We have cut under the \$1.5 billion estimate that was taken into account when the President submitted the budget to us in January.

On that score, Mr. Chairman, I think the committee has presented to the House a bill that is acceptable.

Mr. Chairman, at this point I insert two tables on this point:

TABLE 1.—Treasury Department estimates of revenue effect¹ of bill as amended by the Committee on Ways and Means when changes are fully effective, without taking into account the effect on the economy of the provisions

[In millions of dollars]	
	Amount
Revenue bill of 1962:	
Investment credit.....	-1,175
Withholding on dividends and interest.....	+650
Mutual banks and savings and loan associations.....	+200
Entertainment expenses.....	+125
Capital gains on depreciable property.....	+100
Mutual fire and casualty companies.....	² +40
Cooperatives.....	+35
Foreign items:	
Controlled foreign corporations.....	³ +85
Gross-up of dividends.....	+30
All other items relating to taxation of foreign income, etc.....	+30
Total.....	+120

¹ At levels of income and investment estimated for the calendar year 1962 except that the estimate of revenue gain from change in taxation of mutual banks and savings and loan associations is based on income levels for the calendar year 1963, the 1st year affected.

² Assumes transitional period has been completed for fire and casualty companies.

³ The revenue estimates for the controlled foreign corporation provision do not take into account additions to the tax base, in the form of royalties, rents, etc., which reliable evidence indicates will be forthcoming but which cannot be quantified with an acceptable degree of accuracy.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Mar. 26, 1962.

TABLE 2.—Treasury Department estimates of revenue effect of bill as amended by the Committee on Ways and Means (see note) for the fiscal year 1963 taking into account its estimate of effect on the economy of the provisions

[In millions of dollars]		
	Revenue effect	Effective date
Revenue bill of 1962:		
Investment credit (see note).....	-560	Jan. 1, 1962
Withholding on dividends and interest.....	+195	Jan. 1, 1963
Mutual banks and savings and loan associations.....	-----	Do.
Entertainment expenses.....	+40	July 1, 1962
Capital gains on depreciable property.....	-----	Jan. 1, 1962
Mutual fire and casualty companies.....	-----	Jan. 1, 1963
Cooperatives.....	-----	Do.
Foreign items:		
Controlled foreign corporations.....	-----	Do.
Gross-up of dividends.....	-----	Do.
All other items relating to taxation of foreign income, etc.....	+5	Do.
Total (see note).....	-320	

NOTE.—In estimating the net revenue cost of the investment credit, its favorable effects on the level of investment were computed from statistical relationships in past years between investment and gradual changes in the cost of capital goods (profitability) and cash flow. This procedure thus does not take into account the especially favorable impact on businessmen's decisions to invest of the sudden major improvements in these factors resulting from the enactment of the credit. Taking this into account should produce more favorable effects than the table shows for the investment credit. It will eliminate the overall net revenue loss for the bill as a whole and instead would yield an overall net gain.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Mar. 26, 1962.

Now there is question raised by some in the committee with respect to some of the provisions of the bill that accomplish these overall objectives. Before talking to those particular sections that seem to have raised some questions, let me briefly go over some of the other sections of the bill.

Mr. Chairman, this bill provides some limitation on the deduction of entertainment expenses.

This bill provides for increased taxation of our mutual thrift institutions mutual savings banks and savings and loan associations.

Mr. Chairman, this bill changes the tax treatment of mutual, fire, and casualty companies.

Mr. Chairman, this bill changes the tax consequences with respect to the sale of depreciable property.

Mr. Chairman, this bill changes the tax treatment of the earnings of cooperatives.

Mr. Chairman, the bill also affects three other situations that I want to talk to in greater detail.

First of all, we provide an investment tax credit. The investment credit has been characterized, I think incorrectly, by many who see some fault in it as a bonanza. They think of it in terms of something that we are doing just for the wealthy that should not be done.

Mr. Chairman, I had many questions in my mind when I first heard the suggestion made that the Congress enact an investment credit. It caused me a great deal of concern in the beginning. I began to look at it more closely, I began to analyze it. I began to think of it in terms of its merits and demerits. Let us see why we have it in this bill before you.

Mr. Chairman, over the years we have been trying to provide business with a return of the moneys involved in capital investment, in the construction of plants and facilities that are used in a trade or business, through what we call the rules of depreciation. In viewing this matter, we cannot look just to what the situation here in the United States may be. I think it is necessary for us in the formulation of a tax policy to look at the situation in the free world as well as the situation within the United States. What do we find if we do that?

We find that under our present rules of depreciation, Mr. Chairman, it takes longer for an American businessman to get a return of the investment he has made in plant and equipment here than it does in any of the countries of the free world, countries with whom we compete not only in the world market but also to an extent even here at home.

If you will look to the situation in Europe and in Japan you will find that through an investment allowance of some form or other, comparable to what we are proposing in this legislation, plus their regular rules of depreciation those businessmen are able to recover their investment out of income before taxes in a much shorter period of time than are American businessmen under existing provisions of law.

I thought in terms of why can we not accomplish that? Why can we not just do something legislatively, as my colleagues on the Republican side are recommending, through changes in the rules of depreciation, since that has been the historic way of doing it? I thought first in terms of doing it that way. I began, however, then to think of what it would cost revenue-wise to accomplish as much inducement, incentive, as is provided in a 7- or 8-percent investment credit. We would have to provide, Mr. Chairman, about an 80-percent increase per year in the amount of allowable depreciation in order to accomplish as much encouragement as would be given by a 7-percent investment tax credit.

What do we do if we shorten the lives under depreciation? If we shorten them to a point that does not actually reflect the useful life of the equipment, we reduce the tax through rules that are not a true reflection of the value in a taxpayer's hands on these assets; you are subsidizing that way, Mr. Chairman, just as much as you are subsidizing under an investment credit and at far more current cost.

How will the investment credit work? Consider a businessman who decides that because the average life of his equipment is going up while foreign competitors are getting new equipment, his equipment should be replaced with something more modern. He cuts down his per-unit cost through the use of this better equipment.

Let us say he buys \$1,000 worth of equipment. Under this amendment, Mr. Chairman, we would say that for investments made after December 31 of last year, he may take 7 percent of the \$1,000, or \$70, as a credit actually against the tax that he owes. But in order to prevent the undue use of the credit by those who are the biggest, the

turers, National Small Businessmen's Association, and the U.S. Junior Chamber of Commerce.

A recent survey by Wall Street Journal disclosed that of 68 companies surveyed, only one believed that the credit would have a significant effect on major expansion programs.

On February 23, 1962, the AFL-CIO executive council issued the following statement:

The AFL-CIO has strongly and vigorously opposed the investment tax credit proposal as one that would grant a major tax windfall to corporations without accomplishing its basic purpose of increasing the efficiency of American productive capacity.

I oppose section 2 of the bill for many reasons, the principal ones being that it will not accomplish the results sought to be attained; that it is highly discriminatory between taxpayers; and that it is a billion-dollar-plus experiment of at least doubtful value which cannot be afforded by the United States at a time when its budget is out of balance and in the red to the extent of some \$8 to \$10 billion. It is like injecting an untested drug into a very sick patient instead of applying a known and tested remedy—such as realistic and liberalized depreciation which would be fair and uniform to all segments of our industrial life. Investment credit is in itself a loophole and a windfall to taxpayers who have lagged behind their competitors in plant modernization, and definitely discriminates against and penalizes taxpayers who have expanded and modernized their plants and equipment, mostly upon borrowed money. I predict that if this section is enacted into law, it will be repealed within 2 years.

The administration's approach to tax reform as evidenced by section 2 of this bill cannot provide this Nation with a tax structure that will insure continued healthy and noninflationary economic growth. It only serves to pile complexity upon complexity for the citizens who must cope with a tax code already much too complex. The answer to our tax problems will not be found in patchwork legislation.

In my judgment, which is shared by economists and business organizations throughout the Nation, a far better approach to a sound, fair, nondiscriminatory tax reform program is contained in H.R. 2030 and H.R. 2031, the bills which have been sponsored by my distinguished colleague from Florida and myself for the past 4 years, known as the Herlong-Baker bill. I hope and believe that in the reasonably near future the House of Representatives will have an opportunity to debate and work its will on the Herlong-Baker bill, which deals realistically with the entire tax structure and provides for gradual tax reduction over a 5-year period at all levels and which is geared to a balanced budget; but due to the legislative situation and the closed rule under which we are considering the present legislation we cannot today vote on the Herlong-Baker bill.

Let us return to further discussion of the administration's investment credit approach, which Leon Keyserling, Chair-

man of the Council of Economic Advisers under President Truman, calls a tax bonanza, a windfall or bonanza designated and pictured by a Scripps-Howard nationwide newspaper pictorial editorial as a giant loophole in the right church but in the wrong pew.

Under the most favorable estimates of the Treasury, this windfall will cost the taxpayers about \$1.2 billion in 1963 and an average of about \$1.5 billion thereafter, and this grant, gift, or subsidy will never be recouped by the Treasury. On the contrary, the tax money permitted to be retained by taxpayers under depreciation for plant and equipment modernization and replacement is only a revenue lag and will all be returned to the Treasury as the asset becomes fully depreciated.

How does it work? In simple terms it says that the Government will pay 7 percent of the cost of any new depreciable property—excluding real estate—put into use by the taxpayer. This includes any new equipment put into use since the first of this year. It includes equipment that may be on order or that the taxpayer would buy whether or not Congress approves this subsidy. One company alone will receive a subsidy of over \$80 million a year for expenditures which must be made regardless of the credit. It even includes equipment for gambling casinos, bars, and racehorses. If the taxpayer acquires \$100,000 of new equipment, the Government pays him \$7,000—7 percent—by permitting him to reduce his tax payment by this amount. Even though the taxpayer paid only \$93,000 of his own money for the equipment, he can put it in his books at \$100,000 and he will get this amount back through depreciation.

The provision permitting either the lessor or lessee of property to utilize the credit at the election of the lessor creates a further loophole. A deduction or credit of this magnitude should not be left for trading between taxpayers. In the case of leasing companies, the investment credit is tantamount to a 50 percent tax deduction or an effective tax rate of 26 percent. Why give a tax incentive to some segments of the economy and not to all segments of the economy? For example, the bill in its last minute form extends the investment credit to transient hotels and motels, but not to residential hotels, apartments, or other rental housing. Do we have any assurance that these substantial tax savings will be passed on to the tenants and occupants of motels and transient hotels, and if that should result, which is extremely doubtful, why should it not extend to the tenants and occupants of apartment houses, residential hotels, and other rental housing. Is it planned that we should become a nation of transients?

When this investment credit was first proposed to the committee, I assumed that it would be a temporary shot in the arm—perhaps of 1 or 2 years' duration—and was somewhat intrigued by the idea, but that is not the case. It is the announced policy of the administration that the investment credit is to be a part

of our permanent tax structure and that has been the history of our hodgepodge tax laws. Once a provision becomes a part of the tax structure, it remains almost an immutable as the law of the Medes and the Persians. I strongly recommend that section 2 of the bill be eliminated at a saving of \$1½ billion to our overburdened taxpayers before it becomes even a temporary part of our already too complex and inequitable tax structure.

I am just as strongly opposed, perhaps even more opposed, to section 19 of the bill, which in order to pay a part of the price of this billion-and-a-half-dollar bonanza would impose a 20-percent withholding tax on interest, dividends, and patronage dividends.

The very able Commissioner of Internal Revenue recently estimated that when we count only payments of \$10 or more, there will be more than 350 million savings and shareholder accounts that will be subject to withholding. This provision strikes at the very heart of the voluntary compliance system of tax collection of which we in the United States are justifiably proud. It is conservatively estimated that there will be more than 500 million dividend and interest accounts which are affected by this provision.

The most harmful effect of withholding will be in the field of series E bonds, redemptions of which in February 1962 exceeded purchases. Let us see how it will work. A man or a woman, or a child, by the exercise of thrift and economy has purchased series E bonds periodically and methodically, let us say a \$75 bond every month, expecting to receive under the law at maturity date of about 8 years the sum of \$100. He or she proudly walks up to the teller's window in the bank and instead of receiving \$100, he or she receives \$95, without any withholding certificate but only the assurance that if this \$5 is not subject to Federal income tax, he or she can file a claim for a refund, or if he or she does not reasonably expect that the \$5 will be subject to tax, he can sign a certificate to that effect—which many would put in the category of a pauper's oath—and receive the full \$100. The withholding agent sends the \$5 to the Treasury, along with countless other \$5, \$2, and \$1 bills, and in many instances less than \$1, without even telling the Treasury from whom this money was taken.

In my considered judgment, resentment would build up to such extent that the entire series E program will be imperiled, and so it will be with millions of honest small investors in savings accounts, stockholders of corporations, large and small, dividend recipients of savings and loan associations, mutual savings banks, and cooperatives.

I have received thousands of letters from constituent taxpayers expressing the deepest concern and resentment and the strongest opposition to this withholding tax provision. Retired couples and those approaching retirement have invested small sums over the years in stocks and savings accounts to supplement their social security payments and retirement income, with every dollar of

outgo for food, clothing, medicine, and lodging budgeted. They justifiably feel that the long arm of the tax collector should not be permitted to reach into their dividend payments every 3 months and their savings accounts every 3 to 6 months and appropriate even such comparatively small amounts as \$5 or \$1, or 20 cents. They say that their meager budgets for subsistence will have to be adjusted downward and they don't know whether to start cutting down on their food, clothing, medicine, or their Christmas savings.

By and large, the American taxpayer is honest and pays the tax due on interest and dividends, and the small percentage of those individuals who have failed to do so would gladly pay this tax voluntarily, if liability existed, when informed that the income from interest and dividends must be included in gross income. A simple statement on the tax forms, italicized or in red ink, calling attention to the fact that interest and dividends must be included would cause all honest taxpayers to include in their gross income the amounts they receive by way of interest and dividends. If a taxpayer is dishonest and intends to evade this comparatively small tax, he would not hesitate to sign a statement that he does not reasonably expect this payment to be subject to the payment of Federal income tax. In addition, we passed a law last year requiring each taxpayer to have a number to assist Internal Revenue to find the cheaters; and they can and will, and I want them to find the cheaters.

The only argument used in favor of this proposed law is that, since there is withholding on salaries and wages, there should also be withholding on dividends and interest. On its face this is a good argument, but it is a specious one. In the case of withholding on salaries and wages, there is only one employer-employee relationship at any one time during the taxable year. The employee is permitted to claim any exemptions to which he might be entitled. The rate of withholding on the employee takes into account his normal deductions. Even with these safeguards, the Treasury processes more than 40 million refund claims annually resulting from overwithholding on salaries and wages.

I previously stated that the Commissioner of Internal Revenue estimated that there were more than 350 million interest and dividend accounts which would be affected by withholding if applied only to payments of \$10 or more. When we add to this number the holders of U.S. savings bonds, the patrons of cooperatives, recipients of interest or dividends from insurance companies, and many other sources, there will be at least 500 million accounts subject to withholding.

The American Bankers Association informs us that two-thirds of the recipients of interest from savings accounts receive \$12 or less per year. Let us say that a saver receives \$10 a year in interest or dividends, payable quarterly. Fifty cents a quarter would be withheld. Would that individual saver go to the trouble and redtape of filing a claim for

refund every quarter for 50 cents, or would he say just let the tax collector keep the 50 cents, even though I may not be liable for tax; thus, unjustly enriching the Treasury; or, would he withdraw his savings and keep them in cash in his sock, under the mattress, or in a safety deposit box; or buy tax exempt bonds—upon which there would be no withholding—even if he had to buy these bonds on the monthly payment plan. I am not talking about the extreme case, I am talking about the usual case.

Bearing in mind that there are currently 40 million claims for refunds on withholding from salaries and wages, the amount of refund claims under this section 19 would be astronomical. Treasury would have to employ thousands of persons to even look over the claims, much less process them.

I strongly urge that section 19 be eliminated from the bill.

And now, let us discuss very briefly not only the overall budgetary effect of the motion to recommit, which I believe I have portrayed rather fully, but also its immediate effect on fiscal year 1963.

If we strike section 2—the investment credit provision—we save \$1.1 billion in fiscal year 1963.

Section 19—the withholding section—is estimated to produce \$170 million in fiscal year 1963. Simple arithmetic shows a saving of \$940 million to the taxpayers in the year just ahead, which begins July 1, 1962.

This is a lot of money and is not chickenfeed in my concept of government and finance.

I urge you to join me in voting for the motion to recommit, and to give the overburdened American taxpayer, John Q. Public, a billion-dollar ease on his tax burden. With this burden removed from his shoulders, he will walk a bit straighter in the hope that further relief may be in store for him in the years ahead.

Mr. POFF. Mr. Chairman, will the gentleman yield?

Mr. BAKER. I yield to the gentleman from Virginia.

Mr. POFF. Did I understand the gentleman correctly to say that he would offer no substitutes for sections 2 and 19?

Mr. BAKER. I did not so state. I shall restate what the motion to recommit will be. It will simply be to direct the Ways and Means Committee forthwith to eliminate section 2 of the bill, which is the investment credit provision, and to eliminate section 19 of the bill which is the withholding tax provision. That leaves the balance of the bill intact. That will be the motion to recommit. We substitute nothing.

Mr. HARVEY of Indiana. Mr. Chairman, will the gentleman yield?

Mr. BAKER. I yield.

Mr. HARVEY of Indiana. I have listened with a great deal of interest to the debate on this bill. I was considerably disturbed by a statement made earlier that many millions of dollars are escaping the tax collector through the fact we are not withholding on dividends and interest.

I wonder if the gentleman could enlighten me as to how this is happening.

How could this many escape the tax collector?

Mr. BAKER. I may say to the gentleman I have covered that in the body of my remarks. It is my judgment very few recipients of interest and dividends intentionally fail to include them in their gross income. There is an educational campaign going on, and there are various things in italics of red ink that you must include interest and dividends in your gross income. This would solve most of the problem. All honest taxpayers would do it and a few dishonest ones would not be deterred by what the able chairman says about the signing of a certificate he does not reasonably expect that he will be subject to a tax. He would sign it just the same.

Mr. ALGER. Mr. Chairman, will the gentleman yield?

Mr. BAKER. I yield to the gentleman from Texas.

Mr. ALGER. I think the gentleman's answer is excellent. I would add to that if it is not also true we have taxpayer identification numbers, automatic data processing, the cost of which is being borne by the taxpayers, and this would trip them up if they should evade paying their taxes. This is now being followed by the administration.

Mr. BAKER. I may say to the gentleman that only last year our committee reported and the Congress passed a bill numbering every taxpayer in the United States. You are all numbered, and every dividend above \$10 dollars under existing law is recorded now in the Internal Revenue Department. It can be collected. Under this withholding there will be hundreds of millions of claims for refunds that will cost the Government a great deal, and they will need thousands of additional employees. I think this would cause more loss than the series E bond program.

Mr. MILLS. Mr. Chairman, I yield 15 minutes to the gentleman from New York [Mr. KEOGH].

(Mr. KEOGH asked and was given permission to revise and extend his remarks.)

Mr. KEOGH. Mr. Chairman, I must first and immediately pay my deep and abiding respects to the very distinguished and dedicated chairman of the Committee on Ways and Means, who on occasion even takes on some of the aspects of a slavedriver, but at least we take comfort from the fact he drives no one harder than he is willing to work himself. It is my prediction, Mr. Chairman, when this year and this Congress will have come to an end he will have erected for himself and for his committee and for the Congress a legislative monument that will remain resplendent for many years to come.

I would also like to pay my respects to his small but dedicated and efficient staff, beginning with the very able and dedicated Chief Counsel Leo H. Irwin, and the very able and dedicated assistant chief counsel, John M. Martin, Jr., and going down or up through the rest of their capable and hardworking staff to the genial and ever helpful and cooperative Walter Little and Hughlon Greene, as well as to the staff of the

Joint Committee, the Legislative Counsel's office, Secretary Dillon, and Under-Secretary Fowler and Assistant Secretary Stanley Surrey, who have on occasion displayed with and to the committee a great patience, perseverance and understanding.

I address myself to the provisions of section 8 of the bill dealing with the taxation of mutual thrift institutions.

In the legislative process, decisions must be reached. In any piece of complicated legislation, no Member of Congress is able to dictate that each portion of the bill should come out exactly according to his own preferences. The Revenue Act of 1962 is an excellent bill overall and it will deal with the problem of improving our rate of capital growth and the growth of national productivity.

The incentive to capital growth will come primarily from the investment credit. If we are to devote more of our national output to providing capital goods, however, there will be less available somewhere else. This is the matter of paying for the credit. The revenue-increasing portions of the bill include many sound reforms of our present tax structure such as the elimination of the large-scale tax evasion with respect to dividend and interest income.

Before commenting on the specifics of the mutual thrift provisions of the bill, I would like to indicate generally the problem presented to the Committee on Ways and Means in this area and the committee's general approach to the solution of this problem.

The committee was not impressed with the extreme position taken by the commercial bankers that mutual thrift institutions should be taxed under the same rules applicable to commercial banks. There were three main reasons for not accepting this argument. In the first place, a mutual thrift institution is quite different from a commercial bank.

A commercial bank provides a wide range of services not provided by mutual thrift institutions. A commercial bank's time deposit business is largely an extra which they provide for people who will be in the bank on checking account business anyway. A mutual thrift institution is primarily concerned with investment of savings and it makes no pretense of offering one-stop banking services as does the commercial bank. The degree of competition between these two types of organizations has been vastly exaggerated.

A further difference between the commercial banks and mutual thrift institutions has to do with the source of funds. Any commercial organization has access to capital markets as a source of growth funds, a source not available to mutual organizations. Fair tax treatment requires that this difference be taken into account.

Finally, the lending and investment policies of the two types of organization are quite different. The mutual thrift institutions are primarily concerned with investment in long-term real estate mortgages. The commercial banks on the other hand have a variety of prospective investments, mostly short term, and they clearly regard the investment

in home mortgages as of very minor importance. This last fact is clear in the record of commercial bank lending in periods of tight credit. In 1957 while the aggregate increase of financial institutions in ownership of nonfarm home mortgages was close to \$9 billion, commercial banks increased their holdings of these mortgages by only one-tenth of \$1 billion, slightly over 1 percent of the total amount of new home mortgage money. That same pattern was repeated in the tight credit period of 1960. When the total increased investment in nonfarm home mortgages was \$11 billion, the commercial banks increased their holdings in these assets by one-tenth of \$1 billion.

In both of these periods the commercial banks took in a large part of the growth in savings deposits, \$5 billion in 1957 and \$4 billion in 1960. The point is simply that in these periods of tight credit they had other things to do with the new money deposited in savings accounts than to supply funds to the home construction industry. In periods of tight credit or easy credit, however, the mutual thrift institutions have continued to place 80 to 90 percent of their deposit growth in increased ownership in home mortgages.

This difference in investment policy emphasizes the point that a mutual thrift institution is a different kind of organization from a commercial bank but it emphasizes also that the matter of investment losses is quite different between the two types of organizations. Home mortgage investments are long-term investments with different risk characteristics than short-term commercial paper. It was clear to the Committee on Ways and Means that loss reserve provisions applicable to loss experience on commercial paper have no relevance to an appropriate reserve on long-term real estate loans.

Actually there is no certain formula that will tell us what is the exactly appropriate loss reserve for long-term real estate loans. The very uncertainty of these losses is the problem. In approaching this question, the committee took the approach of analyzing various reserve formulas in terms of their impact on the supply of home mortgage funds.

In this light, I have no doubt that the Congress was wise in 1951 in adopting the 12-percent formula in connection with the bad debt reserve provision of mutual thrift institutions. The principal consequence of this decision of the Congress was the development of a flourishing savings institution that has provided a steady flow of funds to the housing industry. It is largely because of the strength of these mutual institutions that the construction industry has been able to flourish through periods of tight credit when the commercial banks have other things to do with their money as they had in 1957 and 1960. The growth itself, I might add, has brought its problems to these institutions, namely, the revival of the tax issue.

Applying this test of results to the question of what should the loss reserve be in 1963, it was clear to the committee that any loss reserve such as that pro-

posed by the commercial banks would very adversely affect the rate of home building, and through this, it would seriously depress the construction industry. I need hardly add that the health of the construction industry has historically been crucial to the health of the economy.

While the commercial bank proposal was too harsh, it must also be said that 1963 will be different from 1951, and the reserve provision that served well in the fifties might be overly generous now. The Ways and Means Committee reached a new reserve formula that is reasonable to the circumstances. It will impose a substantial tax burden on the mutual thrift institutions but still one that can be handled without serious repercussions on the flow of funds into home mortgages.

At current levels of activity, the mutual thrift institutions will be earning, in 1963, income of about \$1 billion a year, after the deduction for interest and dividends to depositors but before any reserve provision. Under the 60-percent reserve formula under the bill, which will be the usual formula for computing the reserve deduction, the tax will be close to \$200 million. This will mean that combining the addition to the loss reserves and the income after tax, the mutual thrift institutions will be able to add to capital accounts about \$800 million under the new bill.

In recent years the annual growth in deposits in the mutual thrift institutions has been building toward \$10 billion a year and the mutual thrift institutions have been able to maintain, in the aggregate, about 8 percent of these deposits in their capital accounts, that is, in capital, surplus, and loss reserves. They have considered that this 8-percent capital ratio was adequate to the increased risk exposure involved in this rapid rate of growth.

As I have indicated, under the bill, the amount that the institutions will be able to add to their capital accounts will be approximately 8 percent of the prospective increase in deposits. This means that the mutual thrift institutions in the aggregate will have sufficient funds after taxes to maintain the kind of growth that they have had in the past. The tax under the bill will not, therefore, force the institutions to cut dividend rates or to take other steps that will materially affect their growth rate. The bill will not have any appreciable effect on the availability of home financing.

Mr. Chairman, I now direct my remarks to section 4 of the bill.

The bill provides that a deduction for entertainment expenses will be allowed only to the extent that the taxpayer establishes that the expense was directly related to the active conduct of his trade or business. Under the amended law, the taxpayer must show a greater degree of proximate relation between the expenditure and his trade or business than is required under present law. He must show more than a general expectation of deriving some income at some indefinite future time. He will not be required to show that income actually re-

sulted for every allowable entertainment expenditure, however.

It was the committee's intention that the taxpayer show that the anticipated benefit to the taxpayer's business was sufficient reasonably to justify the expense for the entertainment. It was not the intention of the committee to disallow expenses for good-will entertaining but rather to permit IRS to question the business wisdom of any entertainment expense and its ultimate disallowance if the prospects of the expense ultimately benefiting the business of the taxpayer were remote. Thus, entertainment expenses must be reasonably expected to increase or benefit the business of the taxpayer. A test would be whether a prudent man in a similar trade or business might reasonably be expected to incur the expense.

Entertainment under circumstances facilitating the conduct of business affairs or carrying on negotiations or discussions relating thereto would ordinarily be expected to benefit the business. So also would be typical, reasonable, good-will entertainment expenses such as "hospitality suites," or business banquets, and so forth, at a business convention. The committee did not intend to disallow reasonable good-will entertaining at conventions which is so important to the economy of many communities in the United States. These expenses afford little opportunity for fraud since the occurrence of a convention is an easily established fact, and the location of the convention away from the home of the taxpayer as a general rule presents little opportunity for the taxpayer to entertain his family and friends rather than true business associates. Convention entertaining is perhaps the most typical type of good-will entertaining by businessmen. Generally, this type of entertaining affords the taxpayer the best opportunity to create good-will among his customers or prospective customers because it is an occasion when his customer is away from home and business and, consequently, accessible by the taxpayer.

It was not the committee's intention to disallow good-will entertaining but merely to require that it be reasonable. Thus, the committee never indicated during its deliberation as suggested by the committee report that the absence of the taxpayer or his representative from the entertainment activity would indicate that the entertainment was not directly related to the conduct of the taxpayer's trade or business. All the facts and circumstances pertaining to the entertainment activity would have to be considered to determine whether a given expenditure was so related to business as to be deductible under this section. The absence of the taxpayer from the entertainment activity might well indicate that the taxpayer could expect little business advantage from the expenditure. On the other hand, other evidence might well indicate that the expense was perfectly reasonable and the anticipated benefit to the taxpayer's business quite substantial even though the taxpayer were absent provided good will for the business was created through the expenditure.

I also have comments on section 4(b) of the bill.

In limiting living expenses while in travel status to a reasonable allowance, it is the intention of the committee that the reasonableness of these expenses will depend upon the facts in individual cases. For example, criteria or standards such as the locality in which travel is performed, the customary and usual standard of living of the person traveling, the purpose of the travel, and the relationship the travel expense bears to the anticipated benefit to the taxpayer's business should all be considered as factors for determining whether an allowance is reasonable in an individual case.

I now want to talk about the provision for withholding of tax on dividend and interest income which is provided by the committee bill and which is involved in the recommittal motion.

This is the feature of the bill which is described in the separate views of the Republican members of the Ways and Means Committee as producing "massive overwithholding." It would be more accurate to describe those separate views as massive misrepresentation.

First let me make very clear the problem with which these withholding provisions deal. At the present time, we estimate that there is nearly \$4 billion of dividend and interest income annually which should be reported as taxable income on tax returns but which is not reported. The tax evasion involved in this failure to report income is over \$800 million. This estimate of \$4 billion of under-reporting is computed after making allowance for the dividend and interest income that goes to tax-exempt organizations and to individuals whose gross income is so small that they are not required to file tax returns. The general magnitude of this figure is confirmed by audit samples conducted by the Internal Revenue Service. Four billion dollars is the amount that should be on tax returns but is not there.

The separate views in the committee report develop the argument that eventually this tax evasion problem can be solved by more intensive use of information returns from dividend and interest payors which can be matched up by the Internal Revenue Service with individual tax returns to find out whether or not the dividend and interest income which is reported as being paid has also been reported as received.

As a mechanical job, the matching of these information returns on any comprehensive basis is simply impossible manually without an enormous increase in the staff of the Internal Revenue Service. Over the next 5 or 6 years, the Internal Revenue Service will have installed sufficient automatic data-processing equipment to do a great deal of this matching of information returns and tax returns. Even if we were content, however, to put up with another 6 years of massive tax evasion, it is not reasonable to expect the Internal Revenue Service to solve this underreporting problem by use of automatic data processing—ADP—alone. In the first place, to even make a pretense of doing the job by ADP the banks, for example, will have to in-

crease enormously the number of information returns they now file on interest paid. Presently, they file one-half million information returns a year. This would have to be increased to 150 million. This is admittedly a far greater administrative burden on the banks than the burden involved in the withholding provisions of this bill.

Let us assume, however, that we do follow the line of the separate views and require information returns on all interest, and which with the present information returns on dividends would produce about 250 million information returns to be matched up with 60 to 70 million individual returns every year. If the Internal Revenue Service acquires more automatic data processing equipment than they plan to acquire over the next 6 years—and, incidentally, the present Treasury appropriation bill cuts back on the present plans—the technical matching problem could be handled.

Matching, however, does not produce revenue. The machines will turn out a list of discrepancies which would have to be individually processed. The discrepancies might be explainable in a number of ways besides underreporting. These various discrepancies would have to be processed initially by correspondence and in many cases by a revenue agent; and, once the liability was established clearly, it might be necessary to invoke the deficiency collection procedures.

All of this would mean an increase in bureaucratic redtape and would call for the creation of more jobs in the Internal Revenue Service. As a believer in Government efficiency, this does not strike me as a very reasonable way to collect tax liability on individually relatively small amounts of dividends and interest. I say that this is not a reasonable way to collect the tax because a far more reasonable method—namely, withholding—is at hand to deal with the largest part of this underreporting problem, a method that will bring in more revenue, presently due and owing, at less cost.

Actually, withholding will not eliminate all of the underreporting and all of the tax evasion. Withholding will be at the rate of 20 percent and it will not settle the tax liability of individuals whose rate is higher than 20 percent and who have unreported dividend and interest income. Of the \$800 million plus of revenue that is lost, we estimate that \$650 million will be recovered through withholding. Automatic data processing of information returns is the efficient way to deal with the remaining larger tax evasion in the higher tax brackets where the revenue involved per case will justify the administrative costs.

For the mass of dividends and interest where there is underreporting, withholding is a simple and efficient way of dealing with the problem.

As a technical matter, the dividend and interest withholding involved in the committee bill is simple. Partly because of the newness of the idea, in this area some people have assumed that this is complicated procedure but this is not the case. Consider a bank that presently pays interest of 4 percent. Once with-

holding becomes effective, in computing the interest to be added to any passbook, it would simply use 80 percent of this, that is, it would credit interest at a rate of 3.2 percent, or \$32 on a \$1,000 deposit. The individual need only divide this by 4 to find that \$8 is the amount of interest that has been withheld. He would add this to the \$32 reported as gross interest income and he would take credit for the \$8 as the portion of his final tax liability that has already been paid, just as he takes a credit for taxes withheld on wages.

So far as the actual withholding is concerned, there is nothing more complicated than this. The bank does not have to submit to the Government detailed records of how much was paid on each account. This extra reporting by interest payors would, however, be required if we rely exclusively on ADP.

The provisions in the committee bill providing special treatment for cases where there is apt to be overwithholding are also quite simple in application. So far as exemption certificates are concerned, these would be filed by all individuals who do not expect to have any tax liability for the year. An individual who has an appreciable amount of dividend and interest income is required to file a quarterly estimate and pay tax currently if he reasonably expects that his income for the year will exceed certain levels, just as such estimates are called for under present law. The exemption procedure certificate is simply the other side of this coin. It is virtually the same as the decision an individual makes who is not subject to wage withholding and who determines that his income is low enough that he does not have to make a quarterly estimate of tax.

For people who do expect to have some tax liability but less than the amount of their withholding, the bill provides for quarterly refunds. By and large, these are people who would under present law be required to make quarterly estimates but who under withholding, instead of having additional amounts to pay for each quarter, would receive a refund because the amounts withheld would have exceeded the tax liability. The bill sets up a procedure for calculating this quarterly refund which will be quite simple from the taxpayer's standpoint.

For corporations and tax-exempt organizations that might be subject to withholding on amounts that they receive in excess of their tax liability for the year, the bill contains a provision allowing the organization to calculate its current refund entitlement and simply subtract this amount from money that it is withholding on dividends, interest, or wages and would otherwise have to pay over to the Treasury. These organizations, in effect, can get their refunds immediately by a simple book-keeping adjustment.

This withholding system is efficient as well as simple. We might look first at the matter of the amount of overwithholding that will be produced. Presently, there are approximately 50 million tax returns which indicate some amount of withholding on wages. On

37 million of these, there has been overwithholding which requires a refund. That is, 73 percent of the returns involve overwithholding. The Treasury estimates that under the bill approximately 18 million individual returns will indicate some amount has been withheld on dividend and interest income. On these, it is estimated that 2 million or about 12 percent will involve overwithholding on dividends and interest—with half of these below \$10 a year; 73 percent of returns with wage withholding are now overwithheld; 12 percent of the dividend and interest cases will involve overwithholding.

This is what the separate views call, with poetic license, "massive overwithholding."

Let us look at this overwithholding problem in another light. What is the burden on the taxpayer of overwithholding? Consider the exceptional case of a taxpayer receiving dividend income subject to withholding who must borrow money from a bank to replace the amount that has been withheld. He could pay off his loan with his quarterly refund. The cost of overwithholding to him will be reduced to the amount of interest that he has to pay on this short term bank loan. Of course any individual with dividend paying stocks would have no difficulty borrowing this money from the bank at 6 percent.

I think it is an eye opener to see just what this interest cost amounts to. The interest cost would be just \$1 a year for each \$10,000 worth of stock that the individual owns. This on the assumption that the total amount of withholding would be overwithholding. If, in fact, his tax liability was equal to half of the amount withheld, the interest cost of financing the overwithholding is 50 cents a year for each \$10,000 worth of stock.

As a matter of fact, the loss of income involved in temporary overwithholding is such a trivial problem that many individuals in this country do not take all of the withholding exemptions to which they are entitled under wage withholding for the simple reason that they want a refund at the end of the year.

I have no doubt that most Americans appreciate the existence of wage withholding. Obviously, there are many people who arrange to make their withholding higher so that they will have a refund at the end of the year. It is an interesting point that when wage withholding was first discussed in the Congress exactly these problems of overwithholding were thrown into the argument to disparage the system. This problem of overwithholding has been magnified. It is almost staggering to see how trivial this problem is when it is exposed and examined in light of all "hoop-la" about hardships and so on. The interest cost of overwithholding on stocks that I have just described is less important than a price change on a \$100 share of stock of one one-hundredth of a point, literally, 1 penny, a price differential far too trivial for brokers to consider. Percentage-wise, the cost of this overwithholding is smaller in relation to the

value of the stock than 1 hour is in relation to a year.

I think the conclusion is clear that a system which prevents \$650 million of tax evasion with no greater overwithholding burden than this is certainly efficient. Actually, the so-called overwithholding burden is far too trivial to account for the alleged objections that all of us have received about withholding. Obviously, the people who have real objections to withholding are not the ones who are presently meeting their tax liability and would not be inconvenienced by this trivial interest cost. This leads one to conclude that the recipients generally who are really opposed to dividend and interest withholding may be the ones who have a good evasion system going—the ones who are presently not paying tax on dividend and interest income. These are the ones for whom withholding will really mean an increase in the cost of \$20 for each \$100 of dividend and interest income and this is a group not deserving of sympathy by this Congress.

Mr. Chairman, I do have several questions I would like to direct to the distinguished chairman, the gentleman from Arkansas [Mr. MILLS] so that those who run may read and so that the RECORD may be complete.

Mr. Chairman, would proposed code section 274(a) disallow goodwill entertaining?

Mr. MILLS. The bill does not disallow goodwill entertaining as such. Under the exception for business meals, expenses for food and beverages furnished under circumstances of a type conducive to business discussion are allowed if they are ordinary and necessary business expenses under present law. Our committee report specifically states that these expenses are deductible even when the making of the expenditure merely promotes goodwill. Thus, the proposal should not have any significant effect on the restaurant business.

In addition, the bill sets forth a requirement as to other entertainment expenses that they be directly related to the active conduct of a trade or business. In this connection, our committee report indicates that whether a goodwill expenditure is deductible or not turns on whether this test is satisfied. For example, expenses incurred for a hospitality room at a convention at which goodwill is created through display or discussion of the taxpayer's products will meet the test as directly related.

Mr. KEOGH. Mr. Chairman, business banquets are generally financed by suppliers of the banquet attendees as good-will gestures. They are sizable social gatherings. They frequently involve or have professional entertainment. They seldom are conducive to business discussion; nor for that matter, would it even be proper at some of them to even discuss business. Yet, they are a typical type of what I consider to be perfectly reasonable business expenses. There is little opportunity for fraud in connection with them, and certainly there is little opportunity to entertain

anyone other than a business associate at them. Would proposed code section 274(a) disallow this type of expenditure?

Mr. MILLS. The answer to this question cannot be given precisely without knowing all the facts and circumstances of the case. In many situations of business banquets, the business meal exception would apply because they are held under circumstances of a type generally considered to be conducive to a business discussion. In fact, the committee report specifically states that a dinner which is part of a formal business program is generally regarded as held under circumstances conducive to business discussions.

If the banquet is not held under such circumstances, however, their deductibility turns on whether or not they are directly related to the active conduct of the taxpayer's trade or business. The fact that there is some professional entertainment would not necessarily disqualify them from being directly related. The fact that there is no opportunity to entertain anyone other than a business associate might be one circumstance admissible in evidence to show the direct relationship required by the statute. Each particular case, however, must be decided on the basis of all of the facts and circumstances pertaining to the activity.

Mr. KEOGH. Mr. Chairman, my remaining question on this section is as follows: Convention entertaining is vital to the economic welfare of many communities in the United States, not only large cities but literally thousands of resort areas throughout the country. At conventions, suppliers frequently entertain the conventioners as good-will gestures. This type of entertainment affords little opportunity for fraud since the occurrence of a convention is an easily established fact and the location of the convention away from the home of the taxpayer presents little opportunity for the taxpayer to entertain his family and friends rather than true business associates. This is a typical use of good-will entertainment by businessmen. Is it the intention of the committee to disallow entertainment expenses of this sort by proposed code section 274(a)?

Mr. MILLS. The proposed section 274 would not significantly interfere with the convention business at resort areas in the United States. If attending a business convention is an ordinary and necessary business expense under present law, the traveling expenses of the taxpayer in attending such convention would be deductible, including his cost of transportation and a reasonable amount spent for his meals and lodging. His entertainment expense at the convention would be governed by section 274(a). The test would be whether it is directly related to the active conduct of the taxpayer's trade or business. This would turn on all of the facts and circumstances of the entertainment activities. The business meal exception for food and beverage expense under circumstances conducive to business discussion might cover the entertainment. The committee report specifically states that the expenses of a hospitality room at a

convention at which good will is created through display or discussion of the taxpayer's products are directly related. The fact that there is no opportunity for the taxpayer to entertain his family and friends rather than pure business associates is certainly a circumstance helpful to showing that the expense is directly related.

Mr. KEOGH. The bill, as reported by the committee, limits the investment credit for investments in public utility property to 4 percent. The term "public utility property" is defined in section 46(c) (3) (B), at page 10, lines 6 to 19 of the bill, to include property used in the sale of domestic telegraph service. There are other U.S. carriers, however, which engage in the sale of international telegraph or cable service, as distinguished from domestic service only. Would the gentleman state whether these international telegraph carriers will be entitled under the bill to the full 8 percent credit for investments they make which otherwise qualify under section 46?

Mr. MILLS. Yes; only with respect to the amounts that it invests in the United States.

Mr. VANIK. Mr. Chairman, will the gentleman yield?

Mr. KEOGH. I am glad to yield to my colleague.

Mr. VANIK. Mr. Chairman, I just heard the gentleman's question and the response of the chairman of the committee to the effect that the International Telephone & Telegraph Co. would be entitled to 7- or 8-percent investment credit. Does it not classify as a utility?

Mr. MILLS. As I indicated in response to the question of the gentleman from New York [Mr. KEOGH], these carriers will be entitled under the bill to the full credit for investments they make which otherwise qualify under section 46. The international end of it is largely manufacturing. It also operates its manufacturing business here in the United States.

Mr. CURTIS of Missouri. Mr. Chairman, I yield such time as he may desire to the gentleman from Virginia [Mr. BROYHILL].

Mr. BROYHILL. Mr. Chairman, the title of the legislation now before us is "A bill to amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes." More properly, it might be called a bill to provide windfalls for a favored few businesses, to create additional defects and inequities, and to compound the confusion and injustice in our tax system.

These are exactly the purposes that would be accomplished if this bill should become law as it was brought before the House by the majority members of the Ways and Means Committee.

The bill was so bad as originally reported by that committee that even the committee's majority members, on sober second thought, could not stomach their own handiwork—a handiwork they fashioned only under the strongest of pressures from the liberals of the New Frontier. So they went back into executive session and toned down the bill's invest-

ment credit section to the extent of reducing its windfall for the favored few businesses by 1 percentage point and lowering slightly the percentage maximum for the windfalls.

They acted because they realized that the bill they first brought out would unbalance the Federal budget so badly that the more seriously thinking Members of their own party in the House would be compelled by their consciences to vote against the bill. The Ways and Means majority hoped their revisions would enable the administration to twist the arms of enough of their colleagues to insure the bill's passage. At this point, no one yet can be sure whether the strategy worked.

Business as a whole neither wants nor seeks this new concept of tax favoritism. Even the vast majority of big manufacturing industries, which would receive the windfalls under this scheme, do not want it. The clause would give no aid whatsoever to service industries or to the retail and distributive segments of our economy.

The only people who want this investment credit plan appear to be the liberals of the New Frontier. Almost every major organization appearing before the Ways and Means Committee's hearings opposed it. Nevertheless, the administration continues to push for it on the contention that it will stimulate new productive investment which otherwise would not be undertaken. The contention is impossible to justify, in view of the almost unanimous predictions by economists that it will have no significant effect on major expansion plans.

The fact is that the accelerated depreciation plan urged by the minority members of the Ways and Means Committee would do far more to persuade industry to speed up its plant expansion and modernization programs than would the investment credit. Furthermore, accelerated depreciation would be fair in that it would be available to all, rather than just to the favored few as is the administration plan. Its additional advantages are many, more than I care to take the time to enumerate here.

Concerning the bill's provision for withholding on dividend and interest payments, the Ways and Means Committee's minority report describes this plan as an administrative monstrosity. The phrase is a masterpiece of understatement.

The flat 20-percent withholding rate unquestionably will result in massive overwithholding, and primarily on those with small incomes, on those who will suffer the most from having any part of their dividend or interest income withheld. The committee's majority claims such suffering will be negated by the provision for filing of exemption certificates. But the only dividend or interest receivers who can legitimately file such certificates are those who can honestly say they expect to have no Federal income tax liability whatsoever at the end of the year. In effect, this amounts to a virtual pauper's oath. What about the unfortunates who on the basis of preliminary estimates may expect to have a tax liability of \$1 or \$5 or \$10? They

will have the full 20 percent withheld on their dividend or interest payments, and then will have to go through the complicated process of filling out returns on which they claim refunds, then waiting for the longed-for day when they actually receive their refunds.

Withholding on salaries and wages is computed on the basis of giving the taxpayer the benefit of all his exemptions and an effective withholding rate which reflects the standard deduction. Yet the Treasury processes more than 40 million refund claims annually on salary and wage overwithholdings. Think how many millions of refund claims there could be with the no-exemption, no-deduction system on which this dividend and interest withholding scheme is based.

The third gross inequity in this so-called Revenue Act of 1962 which I would like to discuss briefly is its proposed treatment of foreign income of American corporations. Many of us might be willing to go along with the idea of adopting a taxing formula aimed at preventing the avoidance of U.S. taxes by operating through so-called tax-haven companies. But this bill goes far beyond that. Its blunderbuss approach would penalize even the most legitimate foreign operations of the most legitimate American corporations. It will make it virtually impossible for American firms to try to compete in foreign markets through foreign subsidiaries.

Actually, the bill's foreign income section represents economic isolationism at its worst. It is admittedly a scheme to discourage American businesses from operating abroad through foreign subsidiaries—as it was put in some testimony, to discourage the export of American jobs. But the fact is that with a very few exceptions, American firms have established foreign production facilities through foreign subsidiaries in order to compete in foreign markets, not to produce goods for shipment back to the United States.

The few exceptions could be taken care of by special provisions. But this bill goes so far that it will be virtually impossible for American firms to compete through subsidiaries in foreign markets as they have done in the past.

This bill's foreign income provisions represent a reversal of U.S. foreign policy. For some 15 years, it has been based on the benefits of increased participation by American business in the European economy. "Trade, not aid" has been a slogan of Democratic and Republican administrations alike. President Kennedy, himself, has frequently referred to the need for greater American business activity around the world to alleviate our balance-of-payments situation.

That was one hand—the right hand, shall we say. But from his left hand we now have before us his tax bill. Here the situation is different. For here, instead of encouraging American business activity abroad and thereby improving our balance-of-payments picture, this tax bill would seriously deter American business activity abroad and thus would worsen our balance-of-payments problem.

The foreign income provisions of this bill make no sense, precisely as the investment credit plan and the withholding on dividends and income make no sense. The only possible explanation for their advocacy is that the liberals of the present administration believe the provisions will mean greater governmental control over our economy. If that is their belief, they are unquestionably right.

But whether we want such increased governmental control over the American economy is another question. As far as I am concerned, we do not.

Mr. Chairman, I hope all three of these provisions I have discussed can be eliminated from the bill before the House is called upon to vote on its passage.

Mr. CURTIS of Missouri. Mr. Chairman, I yield myself 15 minutes.

Mr. TEAGUE of California. Mr. Chairman, will the gentleman yield?

Mr. CURTIS of Missouri. I yield to the gentleman from California.

Mr. TEAGUE of California. I have a question and I would appreciate very much an answer for the record from the chairman of the committee or the gentleman from Missouri, either. In my home county there are two small non-profit corporations that have been classified as such by the State of California and the Federal Government. They pay no income tax but they do have, in their operations from time to time, savings accounts in the bank, and one of them, I believe, has a few stocks. The other has a few municipal bonds. My question is, Are these dividends and earned interest payments subject to the withholding provisions of the pending bill?

Mr. CURTIS of Missouri. The answer to that, I believe, is that the bank interest is exempt, but dividends from stocks would be subject to withholding.

Mr. TEAGUE of California. It would work a great hardship on these two small corporations which are engaged in youth activities and are just barely able to make ends meet. If 1 percent is withheld from their dividends it would be hard on them.

Mr. CURTIS of Missouri. I thank the gentleman who has pointed out just one of the numerous ways in which this provision is going to work hardship and actually not obtain the results expected of it.

Mr. Chairman, I am opposed to this bill. It is very bad economics, and additionally is bad tax law.

When this matter was before the Rules Committee and we were requesting the opportunity to let the House consider the three features of this bill, the gentleman from Virginia [Mr. SMITH] made the remark that if these three features, the ones that have been pointed out here, investment credit, withholding of interest and dividends, and the taxation of foreign subsidiaries, were removed, the bill would be gutted; and, as a matter of fact, that is a true statement. Take those features out of this bill and it is not a major bill at all, it is just a collection of a few odds and ends here and there.

There is one portion of the bill in which I happen to be strongly in favor, although there is opposition to it, we

have just listened to, that opposition expressed by the gentleman from New York [Mr. KEOGH].

The three features to which I refer are the tax equalization provision, the taxation of co-ops, the taxation of mutual stock savings and loan and mutual banks, and the taxation of stock in mutual fire and casualty companies. Actually those three things, in my judgment, should be on the floor under a separate bill where we could evaluate them, because they all deal with the same tax theory. Other than that I do not think we would miss a single thing in this bill if the rest of it went down the drain.

The basic reason this is bad tax legislation is that this is not a balanced tax bill. The chairman of our committee, for whom I have great admiration, was very careful in his choice of words when he said that the revenue impact for its first full year would show a balance, but the first full year of effect would not be the fiscal year 1963. For the fiscal year 1963 this bill is a budget buster.

The gentleman from Arkansas pointed out that the estimates submitted to our committee would show that possibly this would not be more of an imbalance for the present budget for the fiscal year 1963 than had been anticipated by the President. But here is the thing to be noted. The manner in which these revenues and loss of revenues were estimated was under techniques never before used by the Committee on Ways and Means, never before used by the Treasury Department, and really they are fantastic. They say the imbalance there is supposed to be not more than \$300 million, when actually if we use the traditional manner of estimating revenue loss it is about \$1 billion, because the Secretary of the Treasury has said this investment credit is going to stimulate the economy in these areas and the Treasury will gain tax revenues from that kind of stimulation.

That is not the extent of this pipe-dreaming. That in turn is going to create a psychological effect on the rest of the economy which is going to be stimulated. That is the basis upon which the Committee on Ways and Means has come before this House and said that this is not going to have a \$1 billion imbalance effect upon the budget for fiscal 1963. That, actually, is nonsense.

I asked the Secretary of the Treasury this question when he was testifying before our committee on reciprocal trade, because so much of this bears on our foreign investments. I asked him: "Does this jibe with the very rosy estimates that were made for fiscal 1963 budget on revenues based upon an economy that was going to reach certain high peaks when the months of January and February indicate that we are not moving forward to that extent?"

Indeed, we have to revise our budget estimates downward, not upward. I submit the overall impact of this bill is bad economics.

Note, however, the motion to recommit with reference to this \$1 billion bonanza. When it was \$1.8 billion—really the estimate in this new latest version, which nobody, even our staff of the Joint

Committee on Taxation had an opportunity to analyze. That is the Treasury estimate of what these changes were to be, but the original loss was \$1.8 billion, and about 75 companies would get over \$1 billion of benefits from this particular feature. That in itself is bad tax legislation.

I want to call attention to some—I do not know what adjective to use that would be parliamentarily correct to describe the statement that is contained in the report in regard to this investment credit. On page 8 it is stated:

Realistic depreciation alone, however, is not enough to provide either the essential economic growth or to permit American industry to compete on an equal basis with the rapidly growing industrial nations of the free world. The major industrialized nations of the free world today provide not only liberal depreciation deductions but also initial allowances or incentive allowances to encourage investment and economic growth. This is true, for example, in Belgium, Canada, France, West Germany, Italy, Japan, the Netherlands, Sweden, and the United Kingdom.

I want to say that is not true. I heard that the Secretary of the Treasury has been making these statements. I guess this is where the data comes from. He has been making these statements in speeches, not before the Committee on Ways and Means but outside the Committee on Ways and Means. I think this statement is designed to confuse and relates to another method of depreciation that is used in some of these countries. This, incidentally, is exactly what the Republicans incorporated in the provisions of the revision of 1954, which was bitterly opposed by the Democrats at that time as a bonanza when, indeed, it was not, because it did not give more than 100 percent back in depreciation.

The term "incentive allowance" is used to refer to an allowance or subsidy which is not deducted from the cost for purposes of depreciation. The Secretary, I think, is seeking to create the impression that Canada, Japan, and most of the seven major industrial nations of Western Europe provide for such allowances analogous to the investment credit allowance in this bill. Now, that is not true.

There is no other reason for listing those countries in here than to try to create the impression in the minds of the House that this was analogous.

There are no so-called incentive allowances in Canada, France, West Germany, Italy, and Japan. Thus, in the five major industrial countries, other than the United Kingdom, it has not been deemed necessary or desirable to resort to this gimmick.

Now, the United Kingdom does have some sort of selective incentive which has some counterparts in our existing law. For example, there is an incentive of 40 percent for ship construction. We pay 50 percent of the cost of U.S.-flag vessels, plus the cost of whatever additional feature plus the additional speed which may be incorporated as a national defense measure. In other words, there are these special kinds of incentives in our law,

and the British seem to be somewhat similar to that. They also provide 20 percent for machinery and equipment, but for the most part the useful lives used are much longer even than ours.

What is most important, even with this incentive allowance, British industry has been hard put to even keep pace with its competitors on the Continent who do not have the benefit of this.

Two other nations, Belgium and Sweden adopted it in 1959; and the Netherlands in 1960. Of course, there has been no experience in these countries on which we can rely.

Now, moving on, if I may, to the second feature here, which has been well discussed, I only want to point out a couple of things on the withholding of interest and dividends. First, in regard to the \$4 billion figure that you have heard as the amount that is not returned on the tax return of taxpayers. It was not pointed out that a great part of that—and we do not have our estimates too well in mind—is paid to people who are not taxpayers; children, people over 65. That has been the big problem in the committee. Much of this \$4 billion is not slippage at all. It is not people gypping on their taxes, but the fact that we have got a lot of people who receive these interests and dividends who are not taxpayers. That is the reason the committee has gone to this rather extravagant extreme to try to do something about the nontaxpayers.

Now, the gentlemen on the majority side have used as their plea for withholding of interest and dividends the old, old argument that on its face looks accurate, but just as you examine beneath the surface you see how inaccurate it is. Here is the argument. The gentleman from New York used it. It is used constantly, and that is, if we are going to withhold on the wages and salaries of our people, why should we not withhold on interest and dividends? The answer is a very clear one. Wages and salaries constitute over 70 percent of the income, and when you withhold on wages and salaries, you have a taxpayer. Indeed, we give special credits to that taxpayer who we know is going to pay some taxes so that he can get his proper exemption and so forth. But, interest and dividends constitute less than 10 percent of the income of our people, and we do not have a taxpayer necessarily.

There is the trouble. In fact, we have seen the situation where so many of these people are not taxpayers at all. That is where the logic of this thing falls down. That is why under Democratic administrations and Republican administrations nothing has been done to withhold in this area. What has been done is to try to hit at the slippage because nobody wants to have people gypping on their taxes and to try to get compliance in other ways. Indeed we are moving forward to do that. I think, indeed, we can and that needs to be considered, because this is an administrative monstrosity and, incidentally, is not going to do very much toward cutting down on people who want to evade their

taxes. Anybody who wants to evade, all he has to do is file one of these some 350 million certificates that will be filed and it will be difficult to police it. So it is going to do very little there.

Mr. Chairman, I wanted to devote a little time, if I might, to the problem in regard to the taxation of foreign income. I submitted some supplemental views which are in the committee report on this point. Indeed, the chairman, the gentleman from Arkansas [Mr. MILLS], referred to a statement which I did send out to some of my colleagues saying that this, in effect, was "Yankee come home." Twelve of the twenty sections of this bill that pertain to legislation deal with altering the incidence of foreign taxation. Whatever we do in this area toward tightening it up, regardless of the equity arguments, are going to make a problem for our people abroad in competing with the Russians and in competing with Western Europe. Whatever is done here is going to make it more difficult. I question the pleas in equity. That is the sole basis, you might say, on which the administration has presented these features. I have said this: "Look, now is not the time to change the rules of the road that have been established for 30 or 40 years in how investments abroad are being handled. Now is the time to try to help out in this critical period and to go in accord with the proposals."

Mr. Chairman, I might say that this is contrary to the statements the administration is making in the area of trade—and this actually flies in the face of what we have seen in the trade bill hearings—but let me quote, if I may, from the majority report on the Boggs bill just recently, February 9, 1960. Under the foreign investment incentive section of 1960, designed to aid American business competing abroad. This was the Boggs bill. I would be very much interested to hear the gentleman from Louisiana comment on this and tell us what has happened since 1960 that behooves him to come in and support this kind of bill. Here is what the majority report said. Incidentally, I was not too keen on this:

The postponement of American tax as long as the funds are used in foreign operations is necessary to place the U.S. corporations operating abroad on a competitive basis with other corporations (either U.S.- or foreign-owned) which operate in the same foreign countries and pay only the taxes of the foreign countries. However, by ending the deferral of U.S. tax at the time the funds are brought back for use in the domestic market or for distribution to stockholders, your committee's bill provides assurance that a tax at least equal to the full U.S. tax will be paid before the funds enter the domestic market.

Indeed, that is what the present law is. This was a bill to further encourage and enable our people to compete in the markets abroad.

This bill would seek to make it more difficult for our foreign investment. Our people have told us they have not had a real chance to look at this bill. I wanted to point that out. All this talk about how much work the committee did

in studying this bill—and indeed, it is true—we did devote 10 or 11 months to it—but when the time came to putting in this particular provision in regard to taxing the earnings of foreign subsidiaries, that was not even considered by the committee. It was one of these things that was rushed up, written Lord knows where, in the committee, and voted by a purely partisan vote of 15 to 10. And the 15 knew no more of what was in it than the 10 opposing it did.

So it was put in here. No hearings were held on that aspect.

Mr. Chairman, this can do more damage to the United States in regard to our position in the world today, both for peace and in competing with Russia in the economic field, than anything I can think of. I think it is preposterous that we should even consider legislating in this fashion in an area that is that important to the United States. And frankly, I am disappointed and shocked that the Committee on Ways and Means, in which I have so much pride, would handle an important feature of tax legislation in this summary fashion. And if for no other reason, I am very hopeful that this bill will be defeated so that we may let it go back to the committee and those parts of the bill that have merit—and they are the minor parts, I do recognize—can come out and go on their own merits.

Mr. MEADER. Mr. Chairman, will the gentleman yield?

Mr. CURTIS of Missouri. I yield to the gentleman from Michigan.

Mr. MEADER. Mr. Chairman, first I should like to commend the gentleman from Missouri for the additional views in the report. I think every Member of the House should read those views.

Second, I should like to agree with him that less than 2 years ago, on May 18, 1960, this body adopted H.R. 5, the Boggs foreign investment tax incentive bill, by a vote of 195 to 192. Every member of the Committee on Ways and Means on the Democratic side who voted on the bill voted for that bill. That was to encourage the participation of the American business community in our foreign economic policy, in strengthening the free areas of the world to resist Communist infiltration and domination, economic, and military.

Now this bill in its present form, the earned income tax provision, moves in exactly the opposite direction. How can they possibly justify it when they are also asking us for more foreign aid funds, and for greater latitude in the executive branch on foreign trade for the purpose of furthering our foreign economic policy?

Mr. CURTIS of Missouri. I thank the gentleman for his contribution. Let me say, and I hate to say it, but it is the truth, this is a purely political deal. This was the price that the AFL-CIO demanded for their support of this bill, because they are so strongly opposed to the investment credit aspect of it. I think the gentlemen on the majority side know that that was the price paid at the White House, and the dictates came down to the Ways and Means

Committee and we here are receiving it now on the floor of the House.

Mr. BOW. Mr. Chairman, will the gentleman yield?

Mr. CURTIS of Missouri. I yield to the gentleman from Ohio.

Mr. BOW. Mr. Chairman, I want to compliment the gentleman from Missouri on the statement he has made here today. I ask unanimous consent to extend my remarks in the RECORD immediately following those of the gentleman from Missouri [Mr. CURTIS].

The CHAIRMAN. Is there objection to the request of the gentleman from Ohio?

There was no objection.

Mr. LINDSAY. Mr. Chairman, will the gentleman yield?

Mr. CURTIS of Missouri. I yield to the gentleman from New York.

Mr. LINDSAY. Mr. Chairman, I should like to commend the gentleman on the very pertinent and excellent presentation he has made, particularly in respect of the international aspects of this bill. If this proposal had ever been suggested some years ago on the minority side of the aisle, we would have been accused of being totally reactionary, of being retrogressive, of reaching back into the Dark Ages and being isolationists. This provision is in direct conflict with highly desirable measures designed to bring the European Economic Community and the United States closer together. I submit that if this part of the bill is enacted, the Congress and the United States as a whole will regret it.

Mr. CURTIS of Missouri. I thank the gentleman.

Mr. ALGER. Mr. Chairman, will the gentleman yield?

Mr. CURTIS of Missouri. I yield to the gentleman from Texas.

Mr. ALGER. In view of the Trade Expansion Act of 1962 that is before our committee, and the fact that it seems to be going in the opposite direction from what we are asked here, I would like to ask the gentleman if he would comment at this time for the Members of the House so that it will be in the RECORD, and expand on his views if he can, so that we can read it in the morning, as to the inconsistency of the two bills, taxes on the one hand and tariff on the other.

Mr. CURTIS of Missouri. I thank the gentleman. I would simply make this comment. One question I had directed to all of the administration witnesses who have appeared in behalf of the reciprocal trade extension, and I am referring to the Assistant Secretary of State, the Secretary of the Treasury, the Secretary of Commerce and the Secretary of Labor has been along this line. How can you reconcile the restrictions being imposed in this bill, which was then before them and they had knowledge of it in the foreign investment aspects with the trade aspect. Can you really separate trade from investment, economically? And the answer is in the record. I think there is no reconciliation. The statement of the Secretary of the Treasury was that it was equity reasons that required that we have these aspects in the bill. I again say the equity argu-

ments, in my judgment, do not bear weight, but now is certainly not the time to be changing the rules of the road in this important aspect of our foreign economics.

Mr. ALGER. Is it not also true that Secretary of Commerce Hodges testified on the tariff bill and even though we know how important tax measures are, that he did not know what was in the tax bill or even how it would affect trade and tariffs?

Mr. CURTIS of Missouri. Yes; Secretary Hodges said he was unfamiliar with the legislation, which is a very strange reply.

The CHAIRMAN. The time of the gentleman has expired.

Mr. BOW. Mr. Chairman, the bill before the House is replete with inequities, injustices and other undesirable provisions. Its inevitable effect will be to restrain American private enterprise both at home and abroad, and to enlarge Federal control over private enterprise. But for the moment, Mr. Chairman, I wish to discuss briefly one of this bill's most undesirable sections—that having to do with taxation of foreign income.

The two most obnoxious phases of this section of the bill are the so-called gross-up plan and the controlled foreign corporation tax. Together, they will make it extremely difficult, if not impossible, for American business to compete in many foreign markets and in international commerce generally.

The gross-up proposal would require that a U.S. corporate shareholder must include in its income subject to U.S. taxes, the amount of foreign tax paid by a foreign subsidiary to a foreign country.

The controlled foreign corporation tax in effect would provide for current American taxation of income of so-called controlled foreign corporations—that is, foreign corporations which are at least 50 percent American owned. These taxes would be imposed currently even though the earnings may not have been paid to American owners and may never be paid to them. Furthermore, this scheme allows no deductions for possible losses by these foreign corporations and allows no loss carryovers.

The very able gentleman from Missouri, Mr. CURTIS, an outstanding member of the Ways and Means Committee, expressed the situation succinctly in his separate views on the pending tax bill. He said these two foreign income provisions threaten the ability of American private enterprise to compete and share in world trade, by imposing American taxes on veritably phantom income—income that has never been received.

That is precisely what these sections would do, Mr. Chairman, impose a tax on phantom income.

They would seriously aggravate the tax disadvantages under which American-owned foreign enterprises must operate and compete even under existing law.

To the considerable extent that these proposed imposts would curtail the ability of American private enterprise to participate in the development of the emerging new countries, that much

would these provisions require greater dependence on less-effective governmental aid with its immeasurably greater cost to U.S. taxpayers.

One of the excuses advanced by these provisions is that they will discourage the export of American jobs. But the fact is that with a possible few exceptions, no American jobs are exported because of the existence of American-controlled oversea companies. Rather, such companies use many American-made component parts in foreign manufacturing operations, and they help to create foreign markets for other American products. Department of Commerce figures submitted to the Ways and Means Committee showed that American exports, with respect to U.S.-controlled foreign subsidiaries, amounted to \$2.2 billion in 1959 and \$2.7 billion in 1960.

The foreign income provisions represent a sharp abrupt reversal of American foreign policy. Almost since the end of World War II we have been hearing of the benefits of trade, not aid. A few short weeks ago, President Kennedy submitted to the Congress a special message urging prompt action on his trade expansion program in order to facilitate greater American participation in world markets. The serious deficit in our balance of international payments situation has been a matter of grave concern to Republicans and Democrats alike.

Yet in spite of all this, we have here a program which will discourage American private enterprise participation in world commerce and will inevitably worsen, rather than improve, our balance-of-payments problem; and a program which the administration is doing all in its power to push to enactment. There is no logic to it.

Most of us in the House, I think, probably would vote gladly for special provisions to impose normal U.S. taxes on tax-haven foreign corporations operated primarily for the purpose of avoiding U.S. taxes. But this is not the objective of this bill. The blunderbuss approach of its foreign income sections obviously and admittedly is aimed at all American-controlled foreign corporations, even though they may be unquestionably and historically legitimate and aboveboard.

It is not my intention to take the time now to detail the many injustices and inequities which would be created by the gross-up and its accompanying complicated tax credit formula, or by the controlled foreign corporation plan. For such a detailed discussion, I commend the further views of Congressman CURTIS of Missouri in the committee report. As usual he is sound and constructive.

I do wish to register my complete and hearty disapproval of these schemes and to call the attention of my colleagues to the disastrous effects they would have on the efforts of American private enterprise to expand its activity in world commerce. That activity will contract sharply, rather than expand, if these provisions are allowed to become law. This is an eventuality I believe none of us want to see happen.

(Mr. DENTON (at the request of Mr. KEOGH) was granted permission to extend his remarks at this point in the RECORD.)

Mr. DENTON. Mr. Chairman, there has been so much cloudy controversy over the investment credit section of H.R. 10650 that I have made every attempt to become as familiar with this provision as is possible for someone who does not claim to be an expert on tax matters. I say cloudy controversy because I am convinced that a considerable part of the discussions that we Members have had among ourselves off the floor has come about through failure to interpret properly the tax incentive and to find out just what it would mean to businesses in our respective districts.

Probably the size of H.R. 10650 and of its report have had a great deal to do with this. I frankly must admit that I took one look at the report and quickly put it aside without the least intention of attempting to go through it. Last week I began to hear on the one hand from sources in whom I have complete confidence that the tax incentive is exactly what business needs to retool producing equipment and update plants and factories. Then I was told by sources in whom I have complete confidence that this shaggy piece of legislation has no place in our law books because it does practically nothing for the business community. That is when I began to realize that I was going to have to do some reading on my own.

First off let me apologize to members of the House Ways and Means Committee for refusing originally to wade through the 240 pages of the bill and the 303 pages of the report. I recognize that this lengthy material constitutes considerable work and penetrating thought on the part of the dedicated members of that committee, and I thank them for this contribution. After having studied it, I can now present it to my colleagues as recommended reading. I will not attempt to convey the impression that it is the kind of literature with which you can relax of an evening, but I will say to you that, once you have had the opportunity to peruse it carefully, you will have a much better appreciation not only of the committee's contributions, but also of what this new legislation can do for the general economic welfare.

Mr. Chairman, I also took it upon myself to discuss the tax incentive provision with some of my business friends whose ability to invest in new machinery will be substantially affected by this legislation. We sat down and figured out just what the tax incentive could mean to individual companies. I must confess that our calculations were based on the original proposals, so I have had to revise the figures since learning that the bill would be amended down to 7 percent; yet I still come up with what looks to the average businessman like an excellent opportunity to move ahead and, in doing so, to contribute to the stimulation of the general economy.

So far as I can determine, the tax incentive would be advantageous to large and small coal companies alike. The industry in general has done a remarkable

job in keeping its prices competitive in the fuels market, as shown by the fact that bituminous coal today is sold on the average at the mine for \$4.65 a ton compared with the 1948 average of \$4.99. This reduction was achieved despite the spiralling costs of labor, equipment, and supplies over the past decade and a half. It came about because the industry was willing to invest heavily in modernizing and mechanizing. From a per-man-day average of 6.26 tons in 1948, efficiency of bituminous coal production in this country rose to 14.27 tons per man-day last year, in contrast to 2.1 tons for runnerup Czechoslovakia.

Unfortunately, this progressive spirit is not reflected in sales volumes. Despite these bargain prices, bituminous coal output declined from 599 million tons in 1948 to less than 400 million last year.

The coal industry must be given every opportunity to expand its markets. The tax incentive provision of H.R. 10650 comes as a new hope for coal companies. Much of the mining equipment introduced in the immediate postwar years has by this time become obsolete because of the emphasis placed on research and development in the past decade and more. Replacement should not be delayed. The investment credit, by virtue of making it possible for coal companies to purchase new equipment, can make the difference between stabilized cost and inflation. In turn, the cost savings, no matter how marginal, can make the difference between getting coal orders and in not getting them. With some coal companies working only 2 or 3 days a week, even minute price changes can make the difference between staying in business and closing down.

I appeal to my colleagues to make it possible for the coal industry, whose difficulties have been compounded by a miscellany of competitive inequities, to continue the progress that has enabled it to become the most efficient coal mining industry in the world. Through the tax incentive, the coal industry will at last have an opportunity to enjoy a return to high production levels and our mining communities will perhaps emerge from the chronic economic stagnation that has prevailed these many years.

For the coal-carrying railroads, the tax credit will have a dual benefit. Long burdened by economic woes, they have found it difficult to replenish and replace rolling stock, particularly gondolas and hoppers. The legislation before us today can make it possible for railroads to invest in the equipment they have neglected buying. I also remind my colleagues that many of the diesel engines put into service following the conclusion of World War II are coming to the end of the line and are about to follow the old iron horse to its Valhalla. The new models are expensive, but they are necessary and the railroads should be encouraged to order them now. The tax credit will provide that encouragement, and in consequence it will put some thrust into the economy of communities that build and make parts for railroad equipment.

The second benefit to the railroads will come through increased coal sales. In 1960 the Class A coal-carrying rail-

roads realized a total of \$1,101,612,000 in revenue from coal traffic. That income from moving coal amounted to 13.1 percent of the total freight revenue of those rail lines.

Mr. Chairman, tax incentive provision of H.R. 10650 is needed to give a boost to the coal industry and every industry allied with it. Most of all, it is needed by the hundreds of thousands of families who depend upon these industries for their livelihood.

Mr. KEOGH. Mr. Chairman, I yield 15 minutes to the distinguished gentleman from Oregon [Mr. ULLMAN], a member of the committee.

Mr. ULLMAN. Mr. Chairman, I am sure that I am like many others in this body in that there are some provisions of this bill with which I am not in complete agreement, other provisions which I think could be improved upon, and still other provisions with which I am in strong agreement. The important point from the standpoint of the vote which faces us is that on balance, I think that this bill represents a step forward and, moreover, one which needs to be taken in this session of the Congress.

As is well known, our committee has worked long and hard on this measure, from extensive hearings through even more extensive executive sessions to finally bring to the floor a bill which represents a consensus at least of the majority of the committee. Major revisions of the revenue laws are always complex, always touched with controversy, and, I suppose, practically never satisfy anyone completely. At the same time, it has been 8 years since the last major revision of the Internal Revenue Code and I believe that the record shows that we need to have action now. In the time allotted me I want to indicate why I believe action is needed, as well as making the record clear as to my own views on this complex and important piece of legislation.

The bill before us has two general goals—one might be termed the economic policy goal of providing increased growth, both in our domestic economy and also in our international trade position; while the other general goal is that of improved equity in our tax structure. It must be emphasized that these are complementary goals and that the bill before us is intended to provide a balanced approach. Thus, for example, the tightening of the code in some areas together with revisions of tax treatment in other areas is intended, in a substantial measure, to balance the revenue decreases which will be a result of providing incentives to economic growth. At the same time, it should be remembered that increased economic growth itself will result in increased revenues to the Federal Government. In the face of the continuing heavy burdens which the global struggle places upon the American people, as leaders of the free world, it is this economic growth which offers the best hope for a future lessening of the relative tax burden on individuals.

The central feature of the measure before us in terms of its economic growth objective is, of course, the investment credit provision. The need for such an

objective was pinpointed by the President in his message of last year when he pointed out that "modernization and expansion of the Nation's productive plant and equipment are essential to raise our productivity, to accelerate economic growth, and to strengthen our competitive position in world markets." Behind this statement of need lies the fact that our economic growth rate has fallen off in the past decade at a time when the growth rates of both the Soviet Union and our allies in Western Europe have been twice or three times our own. This glaring disparity is at the root of our balance-of-payments problem on the one hand and reflects a dangerous situation in terms of our national security on the other. It is significant that such other major industrial nations of the world as Belgium, Canada, France, West Germany, Italy, Japan, the Netherlands, Sweden, and the United Kingdom all provide some form of investment incentive allowances to encourage economic growth.

Therefore, Mr. Chairman, I feel that the need for action to secure increased economic growth is established. I recognize that there are differences of opinion as to the best means of attaining our goal—ranging from those on the one hand who argue for a stimulus to consumer spending in the form of increased personal exemption to those on the other hand who would prefer across-the-board depreciation increases. The administration has concluded on the basis of its studies, and our committee has concurred, that the investment credit approach is the most practicable and desirable. Since the minority of our committee continues to argue for the depreciation approach, I want to make clear my own opposition to this substitute proposal. Two points need to be emphasized. In the first place, the investment credit approach goes markedly further than the depreciation approach in securing increased investment for the same amount of revenue lost. Secondly, the credit avoids the distortion of costs which results from the depreciation approach. In other words, the investment credit is both more direct and more effective than the increased depreciation technique of stimulating investment.

While, therefore, I am in support of the investment credit provision of this bill, Mr. Chairman, I must express my deep regret that our committee saw fit to extend it, even in part, to regulated utilities. I was strongly in opposition to this in the committee, I am strongly in opposition to it now, and I sincerely hope that the other body will delete it from the bill when and as they take action on this legislation. In view of the fact that utilities are regulated monopolies with guaranteed rates of return and with a utility responsibility to provide all the investment needed to meet demand, I can see absolutely no reason for offering them a tax incentive to do what they are required to do anyway. Furthermore, our experience under sections 167 and 168 of the present code have, in my opinion, shown conclusively that it is unwise public policy to do so. Since,

under the rule adopted, there can be no opportunity to attempt the deletion of the language extending the investment credit to regulated utilities, I will not dwell longer on this point but I ask unanimous consent to include at the end of my remarks a detailed memorandum on the reasons for excluding utilities from this tax incentive.

I want to turn now, Mr. Chairman, to the remaining provisions of the bill before us—those dealing with improved structural equity. The most important of these, from the standpoint of revenues to be gained, is the provision for instituting a withholding system on dividend and interest income. There is some controversy regarding this provision, but it seems to me that much of it is based on lack of understanding. It must be recognized that we are not imposing any new taxes by the establishment of withholding on dividend and interest income. These are taxes which are already due but which, in many instances, are not being collected. The provision of this more efficient way of insuring collection of these taxes will result, therefore, in greater equity for other taxpayers—both for wage and salary earners and for receivers of dividend and interest income who are already meeting their full tax liability. The institution of withholding on these two forms of income merely extends a system of tax collection which has proved outstandingly successful in the case of wage and salary incomes.

Our committee has recognized that there are some who receive dividend and interest income whose actual tax liability is less than the 20-percent rate to be withheld under this provision. It should be remembered that studies have indicated that this is a relatively small minority of those receiving interest and dividend income. In 1960, for example, studies of the Survey Research Center at the University of Michigan revealed that nearly 80 percent of liquid assets in this country are owned by those with annual incomes in excess of \$4,000 and that less than 10 percent of those with incomes of less than \$5,000 a year own stocks. Still, as I have said, our committee recognized that there are some whose tax liability on these forms of income would be less than 20 percent. In order to secure maximum equity and convenience for these people, we have provided two methods for preventing any substantial overwithholding. One is to allow all such receivers who anticipate no tax liability at all on their interest and dividend incomes to file statements to that effect and to secure exemption from withholding; the other is to allow, for those who have some liability, but less than a 20-percent liability, prompt refunds on any overwithholding that occurs. In my opinion, the proposed withholding system, with these guards against hardship on small income receivers, represents an important step toward greater equity in our tax structure.

Next, I wish to express my strong approval of the provisions of the bill before us dealing with the taxation of cooperatives. The problem here was to

reaffirm the intent of the 1951 act in such a way as to meet the objections which had developed in certain court decisions. Cooperatives themselves have sought legislation which would clarify the tax liability of the individual patron on these patronage refund allocations. Most cooperatives have consistently specified this liability in their bylaws and have argued, with merit I believe, that the patron's membership under such conditions constitutes the logical showing of his consent to the investment of a portion of his patronage refunds in the cooperative. The bill which we have before us accepts this logical approach and strengthens it by requiring that each cooperative must clearly notify its members of the bylaw provisions on this point. In this way, we will be meeting the requirement of patron consent without adopting a procedure that would be punitive and unduly burdensome in character from the standpoint of cooperatives.

A substantial portion of this bill deals with foreign income and with the complex array of operations and transactions which characterize the modern business world. No one would claim that it is an easy thing to achieve equity in our tax structure as between various types of business organizations located in a number of different countries and subject to a variety of tax jurisdictions. But the evidence does indicate that in far too many cases our laws are inadequate to do the job of preventing abuses and insuring the equal treatment which we have every right to demand in our total tax structure.

It is in the interests of fairness to all American taxpayers, then, and not to penalize legitimate overseas investment that these tax reforms are suggested. In the hearings on H.R. 10650, Secretary of the Treasury Dillon said:

We are not critical of investment abroad. We are not critical of investment by U.S. business in Europe in industrialized areas, investment that is made for business reasons. The only thing that we are suggesting, and we feel is equitable, is that special tax reasons are not a good reason anymore for investment in that area, and we are asking that this special incentive, this special privilege be removed.

These remarks of the Secretary set the tone for the foreign income sections of this bill.

Although we are talking in terms of equity, let us admit that the question of foreign investment touches upon the U.S. balance-of-payments problem, a problem to which we have devoted many, many hours and thousands of lines in the CONGRESSIONAL RECORD. A preliminary study for the year 1960 alone shows that the flow of capital from the United States to Western European subsidiaries exceeded dividends remitted to the parent corporations by \$470 million.

Tax deferral on foreign-earned income, for example, creates a twofold problem: earnings are not repatriated and foreign investment is artificially encouraged. This multiple effect is seen particularly in the so-called tax haven countries whose tax rates are well below those of the United States. Any subsidiary organized in one of these foreign

countries enjoys a considerable advantage over a U.S.-based company as long as its earnings are retained abroad. There seems little doubt that many subsidiaries have been located in tax haven countries primarily, if not solely, for tax reasons. Switzerland, Panama, Liberia, the Bahama Islands, Liechtenstein—these are among the nations most favored for the organization of paper subsidiaries. In Switzerland alone, information furnished by the consulate general in Zurich indicates that as of March 31, 1961, there were 517 American-owned corporations, 170 of them created in the 12-month period preceding that date.

The bill before us does not take a meat axe to investment abroad by U.S. corporations. Its purpose is selective—to do some trimming on those types of foreign investment which give an unfair advantage to certain firms at the expense of others.

Certainly, there is no one in the Treasury Department or in the Ways and Means Committee who does not recognize the importance of foreign investment to our economy and to our hopes for the free world. At the same time, all of us have a responsibility to equalize tax treatment and to insure that investment abroad is actually contributing sound economic goals.

Mr. Chairman, no portion of the pending tax bill, H.R. 10650, has been so misrepresented by its critics as the sections dealing with taxation of income earned by Americans overseas.

It is difficult to understand why, because the foreign income provisions of the bill are aimed at a single objective which should cause no controversy—the goal of equal tax treatment of income earned abroad and income earned here in the United States. This will be accomplished by eliminating the use of foreign tax havens and closing other loopholes which allow income earned abroad to escape taxation.

Why should Americans living overseas, and enjoying the protection of American citizenship, escape U.S. income taxes? Why should Americans be able to set up foreign trusts and foreign investment companies to escape U.S. taxation? And finally, why should U.S. businesses operating overseas enjoy tax privileges denied to their competitors operating solely in this country? These are questions that are legitimately raised by anyone with an interest in tax equity and sound economics, for the future health of our economy clearly calls for the elimination of special tax advantages which are making it more profitable for American firms to operate through subsidiaries abroad than to remain in this country and provide jobs for American workers.

Mr. Chairman, I doubt that any Member of this House wishes our tax laws to be used to take jobs away from American workers. But that is precisely the heart of the matter to which I am addressing my remarks.

Our current period of business expansion is now in its 13th month—but 6 out of every 100 able and willing workers in this country are still looking for jobs and unable to find them. We have so far

been unable to develop a complete solution to the problem of recurring recessions and the unemployment and human misery that accompany them. We also face severe economic dislocations brought on by automation and the simple movement and change of a dynamic economy.

We need every job the American economy can provide to take care of our growing labor force and of those whose skills become out-of-date in this world of fast-moving technological change. Can we, therefore, continue to countenance tax laws which induce American business to move out of this country—and take jobs with them? What we need, instead, are tax laws that will help American business to better produce at home for overseas sale and thus help solve our unemployment problem by raising our national output. Such laws are embodied in other sections of this bill.

Those who oppose the adoption of H.R. 10650 say that its foreign income provisions are inconsistent with our traditional American policy of free movement of investment capital. They contend that this legislation moves in a direction opposite to that of President Kennedy's Trade Expansion Act. That is incorrect.

Imposition of U.S. taxes on certain types of American business operations overseas will in no way interfere with the free flow of American capital around the world. Foreign investment opportunities which are appealing on their own merits will not be hindered. The legislation seeks merely to do away with certain situations where present tax avoidance possibilities—of and by themselves—provide the margin of profitability which causes American firms to establish overseas subsidiaries.

Nor will our export trade be hurt. On the contrary, it will be helped. Opponents of the legislation cite the exports made by American firms to their foreign subsidiaries in support of their argument that adoption of this bill will impair U.S. export sales. The precise volume of such export sales to subsidiaries is unknown, though certain companies have testified that their own sales to subsidiaries are quite large. But what about the export sales which are being lost because American firms are manufacturing overseas rather than at home? Does anyone really believe that direct sales to subsidiaries outweigh the \$9.3 billion in sales by American-owned manufacturing subsidiaries in Europe alone?

H.R. 10650 will not interfere with legitimate foreign business operations of American firms. Manufacturing and construction companies will not be affected if they use their retained earnings in their own business—earnings which may now be held idle or used, tax free, for additional investment in new businesses in industrialized countries at the cost of still more American jobs.

The legislation does provide a direct inducement to American firms to invest funds in the underdeveloped countries—thereby supplementing our foreign aid program and removing some of the burden of development aid from the Amer-

and that they can readily project for the years ahead.

4. EXPERIENCE WITH AMORTIZATION PROGRAM IN REGULATED INDUSTRIES WAS UNSATISFACTORY

The unsatisfactory results of attempts to stimulate public utility investment are exemplified by the recent experience with accelerated amortization in the electric utility field. This experience was critically reviewed by the Congress when it restricted the further issuance of amortization certificates in 1957. Chairman Byrd, of the Senate Finance Committee, in commenting on the matter in 1957, stated that he regarded such rapid tax writeoffs for utilities as without any justification whatever because utilities are guaranteed profits.²

The report of the Senate Judiciary Committee made by its Subcommittee on Antitrust and Monopoly concerning the experience of regulated industries under rapid amortization stated:

"Grave consequences have followed the enormous grants of tax amortization to operating utilities in the electric power field. Consumers have fared badly, for the Federal Power Commission rules that lower rates were not the purpose of the tax amortization statute, and the courts have sustained the FPC. As a result of the hearings, the Federal Power Commission surveyed operating utilities and it was established that to an unsuspected extent, tax-free dividends were being paid. Public power witnesses complained of predatory practices by utilities enjoying the lower net taxable income coming from high-depreciation charges, and the subcommittee obtained a listing of all acquisitions made by utilities subsequent to obtaining amortization."³ (See also exhibit 2.)

5. INVESTMENT CREDIT WOULD COMPLICATE RATE REGULATION AND TEND TO BE PASSED ON TO CONSUMERS

The extension of the investment credit to the utilities would tend to bring heavy pressure on the various regulatory commissions to pass the benefit on to consumers in the form of lower rates. Assuming such a pass-through, there would be little, if any, incentive effect to utility investment. While some of the pass-through would serve to reduce costs slightly for industrial users, much of the benefits would affect residential consumption.

There is, however, serious doubt as to how the investment credit might be treated by the various regulatory agencies. While existing law would appear generally to call for the flow-through approach, it is possible that the credit might lead to pressures for some type of tax-normalization approach which would permit the utilities to retain the credit in addition to their fair rate of return on investment. In any event, the credit would gravely complicate the regulatory process and become a continuing source of controversy and litigation.

In view of the conflicting pressures on the regulatory agencies, the treatment of the credit would probably not be uniform in all jurisdictions. Moreover, before the issues were resolved there would be a period of uncertainty and confusion which would not be favorable for investment or the orderly operation of the utilities. Granting the credit to utilities would introduce discriminatory

treatment of different firms, as regulatory agencies respond with different procedures for passing the credit through to consumers.

Special difficulties would be involved in applying the flow-through principle to the credit because, unlike general tax reduction, the credit would vary from year to year with the capital expenditures of the utility corporation. This variance in the tax reduction from year to year would make it extremely difficult for the regulatory authority to determine the proper rate adjustments. Substantial tax credits would be likely to go neither to lower rates nor to additional investment, but into dividends to shareholders. The resulting erratic distribution of the credit in the regulated area and the numerous disputes it would engender would not serve the best interests of either the utilities industry or the Nation in the long run.

6. INSIGNIFICANT EFFECT OF THE CREDIT ON CONSUMER DEMAND

Some utilities have contended that if the credit were passed on so as to lower the cost of service to consumers, this would increase demand and therefore provide a basis for additional investments in production facilities.

Estimates of the possible effect of passing on the entire amount of the benefit of a 4-percent credit in the form of lower utility rates suggest an average reduction of cost to electricity consumers of about 1¼ percent.⁴ For the average residential customer whose electric bill was about \$7.25 a month in 1959, the resulting reduction would amount to about 9 cents a month. Similarly, for industrial and commercial customers whose average electric bill in 1959 was \$880 a year or about \$73 a month, the adjustment would be about 92 cents a month.

These reductions are so small as to be an insignificant stimulus to the consumer in changing his use of electricity, even if the demand were reasonably elastic. While reliable estimates are not available on the elasticity or responsiveness of demand for electric power to price changes, there is reason to believe that it has a relatively low degree of elasticity.⁵

7. HIGH LEVELS OF EXCESS CAPACITY NOW EXIST IN THE ELECTRIC UTILITY INDUSTRY

The high levels of excess capacity which now exist in the case of the electric utilities suggest that the investment credit would not be effective and is not needed in this area.

The data on the growth of excess reserves of kilowatts stated as a percentage of December peak loads indicates that in the postwar period reserve capacity over the peak load reached a level of 19.3 percent in

⁴ The 1¼-percent figure is based on an estimate of \$118 million credit which the electric power utilities would have received on their 1959 eligible investment in relation to \$9.5 billion of operating revenues. With the smaller 3-percent credit figure this reduction for residential consumers would, of course, be smaller.

⁵ Although no estimates of the response of consumer demand to changes in electric prices are available, economic studies have demonstrated an extremely low change in demand in response to the price of heating fuels. For each 1-percent decrease in price, less than three-tenths of 1 percent increase in revenue can be anticipated. (See A. M. Strout "Weather and the Demand for Space Heat," Review of Economics and Statistics 43 (May 1961) pp. 185-192.) Though somewhat greater substitution among fuels can be anticipated in the long run, competition between fuels is effectively limited by the high costs of conversion and one can expect little response from the consumer to a reduction in prices.

1954, declined to 17.3 percent in 1956, but rose steadily since then to a high of 28.6 percent for 1960.⁶ (See exhibit 3.)

The 1956 report of the Joint Committee on Internal Revenue Taxation on the 5-year amortization program indicated that the Office of Defense Mobilization operated on the assumption that an excess capacity reserve in the neighborhood of 24 percent would be required for full mobilization in 1955, which is well above the actual reserves maintained during the Korean war. When reserve capacity reached 20 percent, the goal was closed, presumably because this level was deemed adequate.⁷

8. THE INVESTMENT CREDIT IS ESPECIALLY INAPPROPRIATE FOR GAS PIPELINES

The natural gas pipeline industry has expanded at a very rapid rate without the investment credit. As of the end of 1960, the index of plant investment was around 350, as compared to 100 at the end of 1950.

So far as we know, no desirable expansion or modernization has been prevented by lack of readily available funds.

There is serious question whether it would be in the public interest to encourage any increased rate of expansion in view of the depletable nature of gas. The Federal Power Commission's latest annual reports show that, according to estimates by the American Gas Association, the gas reserve life index for the country has declined from 22.1 years at the end of 1958 to 21.1 years at the end of 1959 and 20.1 years at the end of 1960.⁸ Expansion of interstate natural gas pipelines can be effectuated only with a certificate of convenience and necessity issued by the FPC. The Commission requires an affirmative showing of the adequacy of reserves before any such certificate will be granted. Certification procedures are designed to assure orderly growth in the industry, and will limit the extent to which the investment credit can stimulate growth.

9. THE INVESTMENT CREDIT IS A SELECTIVE STIMULUS TO INVESTMENT

The investment credit has been carefully designed to provide the maximum stimulus to investment in those areas of the economy that compete with foreign producers for markets here and abroad and in those areas of the economy where stagnant economic conditions have caused business to fall behind in its modernization of equipment.

The investment credit specifically excludes buildings and residential construction, as investment in those areas contribute little to modernization of the Nation's industrial productivity. Excluding utilities is but another way in which the impact of the credit is focused on investment that will best strengthen our industrial efficiency.

10. THE CREDIT IS NOT DISCRIMINATORY TO PUBLIC UTILITIES

The credit is not discriminatory to the public utility industry. The legally intended incidence of the income tax paid by the public utilities is on their consumers. Consistent with this principle, the benefits would be passed on to consumers and the utilities would have no net gain from receiving the credit.

11. PURPOSE OF STRENGTHENING INTERNATIONAL COMPETITIVE POSITION OF AMERICAN INDUSTRY IS PRIMARILY APPLICABLE TO BUSINESSES OTHER THAN PUBLIC UTILITIES

The credit is primarily intended to aid manufacturing and other industries in mod-

⁶ Data from June 1961 issue of FPC "Electric Power Statistics."

⁷ U.S. Congress, Joint Committee on Internal Revenue Taxation, "A Report on 5-Year Amortization of Emergency Defense Facilities Under Sec. 168 of the Internal Revenue Code of 1954," December 1956, p. 25.

⁸ 40th annual report, p. 62; 41st annual report, p. 64.

² U.S. Senate, Committee on Finance, "Rapid Amortization of Emergency Facilities," hearings before the Committee on Finance, 85th Cong., 1st sess. on S. 1795, May 7 and 9, 1957, p. 9.

³ U.S. Senate, Committee on the Judiciary, Subcommittee on Antitrust and Monopoly, "Rapid Amortization in Regulated Industries," 85th Cong., 2d sess. S. Rept. No. 1380, Mar. 12, 1958, p. 67.

ernizing, eliminating obsolete equipment, and strengthening their competitive position, with reference to foreign competition. These goals are largely inapplicable to utilities which have for the most part a domestic market and only indirectly are concerned with problems of foreign competition. The need for the credit is clearly greatest in the case of manufacturing and other businesses which need to keep abreast of foreign competition now receiving special investment tax incentives.

12. INDUSTRIALS WOULD NOT CONSTRUCT THEIR OWN UTILITY FACILITIES TO OBTAIN ADVANTAGE OF THE CREDIT

The proportion of the total electric power generated by industrial firms has declined steadily since the late 1930's. (See exhibit 4.) This suggests that the utility industry has been able to make increasing use of economies of scale in large generating plants. Increasing size of generating installations makes it uneconomic for most manufacturers to generate their own power. As the initial investment has an expected life of about 40 years, and most industrial plants would have a highly variable need for power over that period, it is highly unlikely that a shift to self-generating power by industrial corporations would be stimulated by the credit.* In fact the current trend would appear to be in the opposite direction. Many companies now lease production machinery, vehicles, and special equipment, as well as buildings, in order to minimize the capital investment required and permit flexible changes in the product line, method of production, and location.

13. IMPACT OF THE CREDIT ON SMALL UTILITIES

It has been contended that the investment credit would be a boon to small utilities that do not have ready access to the capital market and have a low rate of return. With the exception of a few firms that account for a very small part of the market, there does not appear to be any support for the contention that rates of return are lower in small utilities. Furthermore, about four-fifths of the investment in utilities is concentrated in firms with over a quarter of a billion dollars in total assets that have ready access to the capital market and a rate of return that appears comparable to manufacturing when it is discounted for the lack of risk in utilities and the greater ratio of debt to equity financing. (See exhibit 5.)

14. CONCLUSION

The available evidence indicates that the credit would not achieve its intended incentive to investment in the case of the regulated monopoly industries. The application of the credit would be inappropriate in the case of corporations enjoying sheltered markets and guaranteed rates of return which in effect insulate them from the corporate income tax. Exclusion of utilities from the credit will not impair their right to realistic depreciation revision which may be found appropriate in the light of Treasury depreciation studies. Extension of the credit to utilities on the other hand would cost disproportionate amounts of revenue. As recognized by important sectors of the utility industry itself, the credit might be prejudicial to the best interests of the utilities in the long run.

* Profitability calculations indicate that the value of the credit is less on 40-year assets than on assets with a shorter life. Hence there is less incentive to the industrial producer here than in an investment in production machinery and equipment with a life of 15 years.

EXHIBIT 1

State court opinions favoring passthrough of tax incentive benefits. In holding that utilities should be required to pass on to their ratepayers the benefits of liberalized depreciation under section 167 of the Internal Revenue Code, the Pennsylvania Superior Court said (*City of Pittsburgh v. Pennsylvania P.U.C.*, 182 Pa. Superior Ct. 551, 128 A. 2d 372, 382-383):

"Counsel asserts that, since utilities are an important segment of the national economy, they must likewise benefit. The weakness in this assertion is in failing to recognize the distinct nature of a utility as a regulated quasi-monopoly. As such it may obtain funds for modernization and expansion at the current reasonable cost, and it is allowed to pass this cost on to its customers in an annual depreciation allowance and its annual allowable net return as well. In fixing the rate of return the commission takes cognizance of the cost of capital to the utility. It appears therefore that this general desire of Congress to provide working capital and funds for modernization and expansion is, and has been for many years, adequately met for public utilities through rate proceedings."

Similarly, the Supreme Court of Illinois, said (*City of Alton v. Commerce Commission*, 19 Ill. 2d 76, 165 N.E. 2d 513, 520-521):

"Under the policy of this State, utilities are allowed a rate of return calculated to attract the capital required for necessary expansion. * * * Since in this respect utilities differ from other corporations, the purpose of section 167 would not be thwarted nor would discrimination be introduced into the Federal tax law by requiring utilities to pass the savings of accelerated depreciation on to their customers. * * * utilities are at least partial monopolies, and no competition exists to induce them to pass savings on to the public."

EXHIBIT 2

HISTORICAL PRECEDENT OF ACCELERATED AMORTIZATION

The FPC, in line with perhaps the majority of other regulatory bodies passing on the issue, permitted utilities to normalize income taxes paid with the benefit of accelerated amortization under section 168 of the Internal Revenue Code. (The FPC and many State commissions have adopted the same procedure with respect to liberalized depreciation under sec. 167). Utilities thereby accumulated very substantial reserves. Yet the fact is, as set forth at some length in a report of the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee, that accelerated amortization had no real tendency to encourage construction of emergency facilities.

For example, the subcommittee said:

"Under the policies then (i.e., April 1955) in force, no clear relation to defense needs was required for approval of certificates for electric power generation as they were granted on the basis of total demand, including civilian as well as military needs. The lack of incentive was indicated by the fact that in the few instances where proposed facilities were held ineligible—because of location in target areas—the utility companies constructed them despite the rejection."

The subcommittee further said:

"Of the applications considered by the Department of the Interior and the Office of Defense Mobilization, approval was given to facilities scheduled to bring in 13,013,450 kilowatts. Applications which were denied because of their target area location totaled 5,298,000. All of the projects so denied still are scheduled for completion in 1958, despite the withholding of the tax-amortization inducement."

EXHIBIT 3.—System capacity and peak loads, 1940-60 [U.S. totals for major systems in kilowatts]

End of year	Dependable (adverse water year)	December peak loads	Indicated reserves (excess of dependable over December peak load as percent of peak)
1940.....	34,408,484	27,948,071	23.1
1941.....	37,358,709	31,581,206	18.3
1942.....	39,665,335	32,942,464	20.4
1943.....	42,416,767	37,060,061	14.5
1944.....	43,760,322	37,858,847	15.6
1945.....	45,373,031	37,868,925	19.8
1946.....	45,701,894	43,173,808	5.9
1947.....	48,146,326	47,554,537	* 1.2
1948.....	52,689,808	51,611,873	2.1
1949.....	59,285,449	54,238,069	9.3
1950.....	65,574,230	61,719,096	6.2
1951.....	72,687,954	67,869,836	7.1
1952.....	80,035,407	73,055,403	9.6
1953.....	89,802,220	78,592,567	14.3
1954.....	102,055,254	85,580,848	19.3
1955.....	114,512,107	98,291,077	16.5
1956.....	120,453,230	102,723,432	17.3
1957.....	128,325,252	107,388,343	19.5
1958.....	141,827,422	113,679,341	24.8
1959.....	154,537,818	121,561,168	27.1
1960.....	165,536,249	128,713,488	28.6

Source: June 1961 issue of FPC "Electric Power Statistics."

EXHIBIT 4.—Generating capacity, privately owned electric utilities and industrial establishments 1939-60

[In thousands of kilowatts]

Year	Combined capacity	Privately owned utilities capacity	Industrial establishments	
			Capacity	Percent of combined capacity
1939.....	44,483	33,908	10,575	24
1940.....	45,433	34,398	11,035	24
1941.....	47,631	36,041	11,590	24
1942.....	49,626	37,442	12,184	25
1943.....	51,717	39,128	12,589	24
1944.....	52,610	39,733	12,877	24
1945.....	53,064	40,307	12,757	24
1946.....	53,104	40,355	12,749	24
1947.....	54,816	41,987	12,829	23
1948.....	58,436	45,381	13,055	22
1949.....	63,954	50,484	13,470	21
1950.....	69,106	55,175	13,931	20
1951.....	74,544	60,192	14,352	19
1952.....	79,435	64,349	15,086	19
1953.....	87,053	71,201	15,852	18
1954.....	95,413	79,127	16,286	17
1955.....	103,311	86,887	16,424	16
1956.....	107,790	91,145	16,645	15
1957.....	114,474	97,376	17,098	15
1958.....	126,256	108,202	18,054	14
1959.....	136,510	118,999	17,511	13
1960.....	145,793	128,000	17,793	12

Source: FPC.

EXHIBIT 5

IMPACT OF THE INVESTMENT CREDIT ON SMALL UTILITY COMPANIES

The attached tables present the investment in utility companies, their rate of return, and the percent of total investment held by companies, by size of total assets. For purposes of comparison a similar table has been prepared for all manufacturing corporations. The tables indicate:

(1) Investment is heavily concentrated in utility companies with more than a quarter of a billion dollars of assets. (See table 1.) Firms of that size have ready access to the capital market and can attract equity or debt capital on favorable terms.

(2) The rate of return as reported by utilities of different sizes does not appear to vary systematically (see table 2), while the rate of return increases with the size of the firm. (See tables 2 and 3.) Thus while there may be some justification in special aid to small

manufacturing corporations to help them raise their return, no such aid to the utilities would appear necessary or desirable.

The rate of return as reported by the telephone industry appears higher than that reported by the gas and electric utilities but this is partially the result of the fact that 30 percent of the investment in gas and electric utilities is being depreciated under accelerated methods while only 1 percent of the investment in telephone and telegraph is being depreciated under these methods. When the guaranteed nature of utility income and their generally high ratio of debt to equity capital is considered, utility rates of return are roughly comparable to the return in manufacturing. Ratios of bonds with maturity of one or more years to total capital account are about 16 percent for manufacturing, 35 percent for communications, and 52 percent for gas and electric companies. If equity financing requires a yield approximately $1\frac{1}{2}$ to 2 times that required for bonds, the difference in capital structure alone would account for the observed differences in rate of return.

COMMENTS RELATED TO THE EXCLUSION OF THE UTILITIES UNDER THE INVESTMENT CREDIT

It has been argued that the credit will aid to small utility companies that have difficulty financing new investment projects by issues of stock and bonds in the capital market. Clearly such companies are an infinitesimal portion of the industry. If future investment is roughly proportional to the present investment in utility companies corporations with assets in excess of a quarter of a billion dollars will receive four-fifths

of the \$325 million investment credit that will be granted by the pending tax bill.

If it is desired to achieve a compromise, and accord the small utilities some credit, much of the revenue cost of granting a credit could be removed by coupling the credit with restrictions as to the size of the company which could enjoy the benefit.

TABLE 1.—Investment in electric, gas, and telephone utilities by size of firm, 1958–59

Size of firm	[Percent of total investment]		
	Telephone communications	Gas production and distribution ¹	Electric companies and systems
Under \$100,000.....	0.2	(2)	(2)
\$100,000 less than \$500,000.....	.8	0.3	(2)
\$500,000 less than \$1,000,000.....	.7	.1	(2)
\$1,000,000 less than \$2,500,000.....	.7	.5	0.2
\$2,500,000 less than \$5,000,000.....	.4	.6	.4
\$5,000,000 less than \$10,000,000.....	.8	1.2	.2
\$10,000,000 less than \$25,000,000.....	1.2	3.1	.9
\$25,000,000 less than \$50,000,000.....	.8	4.4	1.4
\$50,000,000 less than \$100,000,000.....	1.9	5.6	2.5
\$100,000,000 less than \$250,000,000.....	.5	16.7	18.3
\$250,000,000 and over.....	92.0	67.5	76.1
Total percent.....	100.0	100.0	100.0
Total amount (in billions of dollars).....	\$24.0	\$14.5	\$40.8

¹ Excluding natural gas production.

² Less than 0.05 percent.

TABLE 2.—Rate of return and investment in public utilities as measured by the ratio of net profits after taxes to total assets less accumulated depreciation and amortization by size of corporation¹ (tax year: 1958–59)

Total assets of corporation	Telephone communication		Gas production and distribution ²		Electric companies and systems	
	Investment	Rate of return	Investment	Rate of return	Investment	Rate of return
	Millions	Percent	Millions	Percent	Millions	Percent
Under \$100,000.....	42.3	5.3	5.2	0.9	3.3	3.0
\$100,000 less than \$500,000.....	190.9	2.9	37.8	1.7	16.7	13.9
\$500,000 less than \$1,000,000.....	158.2	2.9	15.9	.2	19.9	4.2
\$1,000,000 less than \$2,500,000.....	180.0	2.1	65.6	4.0	68.2	6.9
\$2,500,000 less than \$5,000,000.....	99.4	4.9	86.7	5.3	165.0	1.0
\$5,000,000 less than \$10,000,000.....	203.3	4.1	171.2	3.7	88.4	4.5
\$10,000,000 less than \$25,000,000.....	255.3	3.6	451.3	3.9	382.3	3.1
\$25,000,000 less than \$50,000,000.....	202.7	4.0	633.4	3.7	553.1	3.8
\$50,000,000 less than \$100,000,000.....	457.2	3.6	816.2	3.0	1,002.7	3.3
\$100,000,000 less than \$250,000,000.....	120.4	8.8	2,424.7	1.7	7,467.7	2.8
\$250,000,000 and over.....	22,092.0	5.7	9,798.7	2.1	31,019.3	2.8
Total.....	24,002.0	5.5	14,506.7	2.3	40,786.6	2.8

¹ Rate of return is the ratio of net profit after tax to total assets. Investment is the total assets of the company.

² Excluding natural gas production.

NOTE.—The rate of return estimates are based on net income for tax purposes related to net total assets. These rates will be much smaller than book net income related to equity.

TABLE 3.—Investment and rate of return in manufacturing as measured by the ratio of net profits after taxes to total assets less accumulated depreciation and amortization (tax year: 1958–59)

Total assets of corporation	Investment	Rate of return ¹	Percent of total investment
	Millions	Percent	
Under \$25,000.....	310	(2)	0.1
\$25,000 under \$50,000.....	697	(2)	.3
\$50,000 under \$100,000.....	1,771	(2)	.8
\$100,000 under \$250,000.....	5,112	1.3	2.2
\$250,000 under \$500,000.....	6,131	3.8	2.6
\$500,000 under \$1,000,000.....	7,942	3.7	3.4
\$1,000,000 under \$2,500,000.....	12,315	4.6	5.2
\$2,500,000 under \$5,000,000.....	10,237	5.3	4.3
\$5,000,000 under \$10,000,000.....	11,177	6.0	4.8
\$10,000,000 under \$25,000,000.....	17,695	5.6	7.5

TABLE 3.—Continued

Total assets of corporation	Investment	Rate of return ¹	Percent of total investment
	Millions	Percent	
\$25,000,000 under \$50,000,000.....	13,523	5.5	5.7
\$50,000,000 under \$100,000,000.....	18,532	6.1	7.9
\$100,000,000 under \$250,000,000.....	25,586	6.2	10.8
\$250,000,000 and over.....	104,808	5.5	44.4
Total.....	235,836		100.0

¹ Measured by the ratio of net income after taxes to total assets less accumulated depreciation and amortization.

² Losses reported in 1958–59.

NOTE.—The rate of return estimates are based on net income for tax purposes related to net total assets. These rates will be much smaller than book net income related to equity.

EXHIBIT 6

STATEMENTS CONCERNING UTILITY TAX BENEFITS BASED ON INVESTMENT

1. John P. Madigan, the Hartford Electric Light Co., Hartford, Conn., in a speech at National Conference of Electric and Gas Utility Accountants, Chicago, Ill., April 20, 1959, concerning liberalized depreciation (sec. 167):

"In general, the main purpose was to encourage industry to modernize its machinery and equipment. In our industry, however, to be realistic, accelerated depreciation does not stimulate to any great extent the replacement of obsolete equipment. Does anyone seriously contend that our plant would not have been expanded as fully or as rapidly, or that our maintenance program, involving replacements of units of property, would have been curtailed if it were not for accelerated depreciation? Perhaps it achieved all these things for other taxpayers, but certainly not for us. What was achieved was, in effect, nothing more than a reduction in tax equivalent to the lowering of the present corporation rate of 52 percent, and, if income taxes had actually been reduced in such manner, would anyone argue that we ought to be allowed to retain the savings over and above the fair and normal rate of return?"

2. Federal Power Commission, in its 1956 decision in the Amere Gas case, in which it ruled that utilities should receive the benefits of the tax savings under rapid depreciation, said: "The extraordinary ability and willingness to attract capital and construct new facilities causes us to question whether the incentive provided by section 167 of the Internal Revenue Code is necessary or desirable for this industry or will, in the long run, be as beneficial to the public interest." (While this decision related to the gas industry, the FPC statement is even more applicable to the electric industry.)

3. Value Line Investment Survey, in a press release of February 26, 1962, said: "In the past, investor-owned electric utilities (which account for more than 75 percent of the industry) have had to sell new securities to raise 67 percent of their new construction budgets. But, the Value Line Survey points out, a rising cash flow from depreciation and tax savings from accelerated depreciation has recently reduced the need for new capital to about 50 percent of construction outlays. The proposed tax credit for new investment in equipment, if enacted, would further bolster internal cash generation."

4. William R. Connole, former FPC Commissioner, in a dissent in the Amere Gas case in 1956, said utilities "not only have the privilege and the incentive to expand, but indeed have a clear cut, universally recognized and inescapable obligation to do so. * * * And it would be a vain act indeed were the Congress to enact a statute which would purport to cure a nonexistent problem or to provide encouragement where none is needed, indeed where none can be inferred without impugning the willingness of utilities themselves to conform to their existing obligations and the ability of the regulatory community to meet its statutory and constitutional mandate."

Mr. CURTIS of Missouri. Mr. Chairman, I yield such time as he may desire to the gentleman from Pennsylvania [Mr. SCHNEEBELI].

(Mr. SCHNEEBELI asked and was given permission to revise and extend his remarks.)

Mr. SCHNEEBELI. Mr. Chairman, before proceeding with any comment on any part of this tax bill, I want first to congratulate our committee chairman for the tremendously effective job he has accomplished in bringing the bill to the House floor in the form that it now as-

sumes. I have marveled at his single-mindedness and tenacity of purpose and his ever-pervading drive and forcefulness in bringing about this legislation. His logic and concentration is so important in the committee's work, and he brought out the bill in a most expeditious manner considering the diversified thought required by the complexities of the many problems. His patience and tolerance toward committee neophytes such as myself is the mark of an understanding gentleman. I thank him for his cooperative attitude.

There is much in the bill which commands itself to your favorable consideration, approval and action, but, as may be expected in a bill with so many facets and avenues of approach, there are bound to be several areas which lend themselves to legitimate and honest dispute.

I rise to speak of my opposition to that portion of the bill which concerns itself with the withholding of 20 percent of the income arising from dividends and interest.

First of all, the method proposed is inexact, inaccurate, and unnecessary. It is neither workable nor practical. Its operational and clerical problems posed to banks and corporations are immense. It proposes to cover people who are in the zero to 91-percent bracket by a constant 20-percent blanket deduction. In this respect it is different than wage withholding inasmuch as wage withholding closely parallels the bracket in which the wage earner finds himself. However, the withholding rate will tax many people who are not subject to tax in the first instance and will be an inadequate rate for many others who are above the 20-percent bracket. This inexact approach will cause much turmoil and paperwork between the individuals and the Internal Revenue Service with its resultant confusion.

Secondly, the proposal would rob tax-exempt institutions such as hospitals, colleges, as well as pension funds of 3 to 4 months' usage of 20 percent of this large part of their income. These institutions invest their endowment funds in dividend-paying securities and 20 percent of these funds would be tied up for 3 or 4 months by the withholding system. Being deprived of this income, these tax-exempt institutions would have to go out to borrow money to provide the additional working capital needed for their operations.

Since we are opposed to withholding, do we then condone this leakage in Federal tax revenue? Do we recommend that we should tolerate this tax loss in the hopes that the situation will clear up on its own? Definitely not. We deplore this loss, much of which can be attributed to oversight and thoughtlessness.

What then do we have to offer instead of withholding?

First, more effective education of the public by dividend-paying corporations and the banks and savings institutions as well as the Internal Revenue Service relative to the responsibility of the taxpayers in this area. Further, a reminder by the Revenue Service that new elec-

tronic machinery will catch up with them and this action will bring very effective results. The reminders to the taxpayers of the effective use of automation are already bringing some conscience-stricken taxpayers to the point of voluntarily paying back taxes because they are afraid of being caught by automation. Last January, voluntary payments which will yield a total of about \$600,000 were reported and Internal Revenue Commissioner Caplin states that the gradual shifting to automation data processing equipment to check returns has produced payments from taxpayers who believe that they may now be caught.

The second approach instead of withholding is through the scientific and accurate use of electronic processing machinery known as ADP—for automatic data processing. By feeding it the information provided by dividend and interest-paying institutions, each taxpayer's income is definitely cataloged by the push of a button. There should be no haphazard, arbitrary approach such as withholding offers when we have this new modern-day method of the A.D.P. machinery. The United States prides itself upon its scientific advances and technological know-how, so why cannot we put it into effective work in this area where it will do so well?

This year the national processing center at Morgantown, W. Va., will be fully in use as will the ADP machinery at the first of nine Internal Revenue District centers at Atlanta, Ga. Next year, Philadelphia will be fully implemented and by 1966, all nine districts will have complete facilities for this project. Income-producing institutions will be feeding these machines with total information relative to taxpayers. It is interesting to note that banks that report 29 percent of all the savings deposits in the country voted 2 to 1 that they would prefer sending to the Revenue Service information on all interest payments over \$10 a year rather than to submit to withholding provisions. This cutoff point of \$10 would account for more than 95 percent of all interest revenue in the United States.

Not only are the payers interested in this approach to control of taxable income, but so also are the 15 million people who own stock and the more than double that number who receive interest payments. The more than 40 to 50 million taxpayers who receive interest and dividend income are concerned about the proper approach to this problem, and I am sure that your constituent mail reflects this interest in this portion of the bill.

In the interest of testing the good intentions and good faith of the Treasury Department, an amendment was introduced in committee terminating withholding at the end of 1966, at which time ADP would be fully in effect. After a trial period of 3 or 4 years of withholding, a time of appraisal seemed appropriate, at the time ADP was fully implemented throughout the country, and a gage of its value could be reviewed. This amendment was turned down flat since the Treasury Department has no

intentions of giving up this highly unsatisfactory withholding approach. They want to keep their hand in the taxpayers' pockets and grab this money, much of which does not belong to them in the first place.

It is recommended therefore that serious consideration be given to the denial of this haphazard system of withholding with its accompanying exemptions certificates, refunds, claims and counter-claims in favor of more scientific approach of ADP recommended by commonsense and by the 40 to 50 million taxpayers concerned. With the millions of dollars invested in ADP equipment, we certainly have no defense in denying its full and proper use in this field. Accordingly, it is recommended that you vote in favor of a recommittal motion containing the recommendation that the withholding feature of this bill be eliminated, and that we proceed with full use of further education, Internal Revenue Service warnings and the scientific features of ADP.

Mr. CURTIS of Missouri. Mr. Chairman, I yield such time as he may consume to the gentleman from Ohio [Mr. HARSHA].

(Mr. HARSHA asked and was given permission to revise and extend his remarks.)

Mr. HARSHA. Mr. Chairman, I would like to call my colleagues' attention to one phase of the Revenue Act of 1962, otherwise known as H.R. 10650, the omnibus tax bill, that is certainly discriminatory as it applies to some public utilities.

Section 2 of this act states substantially that in the case of public utilities—such as electric power companies, telephone companies, water companies, and local gas distribution companies—the investment credit available is to be only at the rate of 3 percent instead of the 7 percent available to certain other concerns. This is certainly an unconscionable position to adopt* and highly discriminates against an important segment of our free enterprise system.

The President stated in his Economic Report:

We must scrutinize our tax system carefully to insure that its provisions contribute to the broad goals of full employment, growth, and equity.

Unquestionably such discrimination does not contribute to full employment and certainly there is nothing equitable about it.

The President further stated that the tax credit would stimulate investment in capacity expansion and modernization, and contribute to growth of our productivity and output. To deny these public utilities the same opportunity as other domestic concerns is to stifle the expansion and growth productivity in that particular field.

The President further indicates that the stimulus the tax credit provides to new investment will have favorable effects on the level of economic activity during the year and that this will in turn add to Federal revenues. If this tax credit will have such a stimulus on

business in general it certainly would equally stimulate the economic activity of these utilities if given equal treatment or application.

The argument was advanced in the committee report that the smaller credit was provided to certain utilities because much of its benefit in these regulated industries is likely to be passed on in lower rates to consumers, thereby negating much of the stimulative effect on investments. This I seriously question because utilities have a very small margin with which to make much needed expansion and modernization, although most of them earnestly endeavor to keep abreast of the times by sound expansion and modernization. There is always need for more expansion and advanced technology in our utilities.

However, assume this position is true—that the benefits from this tax credit were passed on to the consumers—I ask you, gentlemen, what is wrong with that? Are not our overburdened taxpayers and consumers entitled to some benefits? What better way to stimulate the economy than to give the consumer more purchasing power in the form of reduced rates? Certainly increased purchasing power will create a demand for more products and in turn create more jobs. Obviously this would provide additional revenues for our Government. It would help lessen the burden on unemployment and welfare funds. All of which would do much to enhance the free enterprise system and most assuredly be a contributing factor toward full employment and economic growth. But, no, we are going to discriminate against these utilities. In other words, this administration says we do not want them to have full economic expansion and growth, we do not want the consumer to receive lower rates, we do not want the consumer to have better service and more purchasing power. This is a rather untenable position to say the least.

We have just voted down an opportunity here today to amend this bill and provide for a reasonable up-to-date accelerated depreciation rate so that all free private enterprise could have an equal tax incentive, one that was not discriminating but equitable. One that would have enabled all business to contribute on an equal basis to full employment and capacity expansion and growth.

Now before we are through with this bill you will have an opportunity, I hope, to recommit this legislation to the committee with instructions to delete the tax credit feature and substitute therefore an accelerated rate of depreciation. I urge you to at least treat all business equally and give the utilities an equitable share in this measure.

I contacted one of the utilities in my district about this inequitable tax treatment and asked their position on the problem and I would like to give you the advantage of their judgment on this provision which to my humble opinion seems very sound.

When informed that they would only receive a 3-percent tax credit as contrasted to the 7 percent granted other industries, here was their response:

It would be dreadful to so discriminate against such an important segment of America's free enterprise economy. It seems to us that three erroneous assumptions are made:

1. That the amounts which investor-owned utilities will spend on construction will not be affected by whether or not a tax incentive is available,
2. That utilities not in the transportation field are not subject to competition and,
3. The reduction in taxes would be passed on to electric consumers through the State regulatory processes and, thus, would not serve as an expansion incentive.

We believe these arguments are demonstrably invalid.

1. The availability of the tax incentive to the utility industry would lead to increased capital investment by utilities. The electric utility industry is the most capital-intensive segment of the economy. In most industries, \$1 of plant investment is expected to produce several dollars of annual revenue, but in the electric utility industry it requires about \$4.50 of plant investment to produce \$1 of annual revenue. Because of this relationship between revenue and plant investment, any reduction in the carrying charges associated with plant investment, of which Federal income taxes are an important part—about 25 percent thereof—would have a far greater effect on investment decisions in the regulated electric utility industry than in any other industry.

Further, it is invalid to believe that the public utility industry has no optional investment opportunities, for in this category would come office buildings, garages, service centers, and other similar facilities and associated machinery and equipment not directly associated with providing electric service. In addition to these optional decisions, there are other desirable investments with considerable flexibility as to time the investment is made, such as major interconnection facility investments.

2. The electric industry is engaged in active competition. This is certainly proved by our company, which has vigorously pursued every avenue of technology and management know-how to achieve reduction in price in order to improve our competitive position relative to other energy forms. To lessen the tax credit available to our industry would serve to vitiate these efforts, especially since the inclusion of oil, coal, and natural gas pipelines would provide these other energy industries with a competitive cost advantage that would not otherwise be attainable on the basis of technology or free-market economics alone. For example, in residential heating, electric energy competes with all other fuels, but especially with natural gas.

3. The fact that some or all of the tax benefits would be passed on to the consumers would in no way lessen the incentive for expansion of capital investment. It would tend to stimulate such investment even more. The consequence of a price reduction in the cost of electric energy would be an increase in demand for more service, and certainly through the mechanism of this demand increase capital investment would be stimulated. Indeed, even if it were assumed that through the regulatory processes the entire savings in taxes, resulting from the tax credit, would be passed along to the consumers in the form of a rate decrease or the avoidance of a rate increase, the impact, proved by rate decreases in the past, would be an increase in consumer demand. Historically, an increase in consumer demand has resulted in repeated and large investment expenditures by the utility industry.

Finally, for those concerned with the economy of Ohio, recognition should be given to the encouragement of increased electrification to greatly aid the depressed coal industry.

I believe this same sound reasoning would apply generally to other utilities as well. This discrimination is certainly unjust and contradicts the very purpose for the tax credit. If not corrected in this bill, I trust the Ways and Means Committee will soon see the folly of their position and equitably correct it.

Mr. CURTIS of Missouri. Mr. Chairman, I yield 10 minutes to the gentleman from Michigan [Mr. MEADER].

(Mr. MEADER asked and was given permission to revise and extend his remarks.)

Mr. MEADER. Mr. Chairman, the tax bill, H.R. 10650, which we are considering under a closed rule, has practically nothing to recommend its adoption and contains many provisions which should impel its overwhelming defeat.

The Ways and Means Committee, commencing on May 3, 1961, and concluding on June 9, 1961, took extensive testimony for 24 days, which is contained in four volumes and a total of 3,613 printed pages. Many individuals, trade associations, companies, as well as officials of the Federal Government, spent a great deal of time and effort preparing and presenting their views and, of course, the committee members spent a great deal of time listening to and absorbing the views of witnesses and cross-examining them.

Subsequently, the Ways and Means Committee spent many days in executive session considering the testimony and the possible provisions of a tax bill and arrived at tentative conclusions which were announced at the end of the last session.

Subsequently, in the early part of this year, the Ways and Means Committee met again for many days in executive session, and on February 27, 1962, announced that it had agreed upon certain provisions to be included in the bill introduced by the chairman. Thereafter, H.R. 10650 was introduced, and the Committee on Rules was asked to grant a closed rule. While this request was pending, the Ways and Means Committee underwent another change of position and announced that the bill would be modified again so that the loss of revenue it provided would not be as great.

It is apparent that the Ways and Means Committee, with respect to the foreign income tax provisions of the bill, after exhaustive consideration of the testimony, simply threw all of the expert advice developed painstakingly and at great expense of man-hours together with the committee's own time out the window and adopted punitive provisions whose parenthood is somewhat in doubt.

I wish to direct my comments on H.R. 10650 to the foreign earned income taxing provisions of the bill and their effect on our foreign economic policy.

I do not wish to discuss the technical details of these provisions, most of which are contained in section 13 of the bill, but call the attention of the committee to the very cogent and clearly expressed views of the Hon. THOMAS B. CURTIS contained on pages B 29 to 36 of the committee report.

Mr. Chairman, the April 1956 edition of *Fortune* magazine published an editorial entitled "The American Game," a portion of which I want to quote:

The real source of America's strength lies in its own flexible and dynamic system of private enterprise, and in the projection of that system abroad.

I incorporated the editorial in remarks I offered to the House Tuesday, May 22, 1956—CONGRESSIONAL RECORD, pages 8753 to 8754. I regard that editorial, and particularly the paragraph I quote, as identifying the most powerful and effective weapon we possess with which to fight our ideological war against communism. The real contest is for the minds and attitudes of the peoples of the new nations emerging from colonialism, most of them loosely classified as underdeveloped by our standards. In this contest our deeds certainly will speak louder than words. A demonstration that free economic and political institutions are superior to the organized slavery of communism is ideological cash in the bank of world public opinion; high sounding oratory, slogans and headlines without performance are debits against international good will.

I have always felt that our assistance in economic development overseas should be provided by the American business community with their own capital at no cost to the taxpayers, and that the role of our Government is to foster and facilitate private capital investments overseas by using its personnel and diplomatic sanctions and instruments to break down artificial barriers to trade and investment and thus contribute to the attractiveness of private capital investments abroad.

One of the principal efforts of my service in Congress, has been an attempt to direct the efforts of our Government along those lines. In 1951 I urged the creation of a Commission to study the problem and map a course to achieve that goal. That effort, I am unhappy to say, was unsuccessful—CONGRESSIONAL RECORD, April 23, 1951, pages 4209 to 4212.

In 1956, Congress created the Development Loan Fund. I offered an amendment to the declaration of purposes of the fund to indicate that in assisting underdeveloped areas it was the intent of Congress that we foster free enterprise economies.

As many of you know, that idea was strenuously opposed by both the State Department and the ICA, and it is due, in my judgment, only to the statesmanship and clear thinking and foresight of two of our former colleagues, the Honorable John Vorys, of Ohio, and the Honorable Brooks Hays, of Arkansas, that the free enterprise idea was incorporated into the charter of the Development Loan Fund.

The Congress accordingly reaffirms that it is the policy of the United States, and declares it to be the purpose of this title, to strengthen friendly foreign countries by encouraging the development of their economies through a competitive free enterprise system; to minimize or eliminate barriers to the flow of private investment capital and international

trade; to facilitate the creation of a climate favorable to the investment of private capital; and to assist, on a basis of self-help and mutual cooperation, the efforts of free peoples to develop their economic resources and to increase their productive capabilities.

The Act for International Development of 1961—Public Law 87-195—contains the following provision:

It is the policy of the United States to strengthen friendly foreign countries by encouraging the development of their free economic institutions and productive capabilities, and by minimizing or eliminating barriers to the flow of private investment capital.

In President Kennedy's message to the Congress on March 14, 1961, "Inter-American Fund for Social Progress"—House Document No. 105—there appears the following:

U.S. business concerns have also played a significant part in Latin American economic development. They can play an even greater role in the future. Their work is especially important in manufacturing goods and providing services for Latin American markets. Technical expertness and management skills in these fields can be effectively transferred to local enterprises by private investment in a great variety of forms—ranging from licensing through joint ventures to ownership.

Private enterprise's most important future role will be to assist in the development of healthy and responsible private enterprise within the Latin American nations. The initiation, in recent years, of strikingly successful new private investment houses, mutual investment funds, savings and loan associations, and other financial institutions are an example of what can be done. Stimulating the growth of local suppliers of components for complex consumer durable goods is another example of the way in which domestic business can be strengthened.

A major forward thrust in Latin American development will create heavy new demands for technical personnel and specialized knowledge—demands which private organizations can help to fill. And, of course, the continued inflow of private capital will continue to serve as an important stimulus to development (p. 3669, CONGRESSIONAL RECORD).

In the declaration to the peoples of America of the delegates at Punta del Este, August 16, 1961, one of the goals is described as follows:

To stimulate private enterprise in order to encourage the development of Latin American countries at a rate which will help them to provide jobs for their growing populations, to eliminate unemployment, and to take their place among the modern industrialized nations of the world.

As late as March 7, 1962, in a press conference, the President said:

Private capital is necessary in Latin America. There isn't enough public capital to do the job.

The provisions of section 13 of H.R. 10650, which relate to taxation on foreign earned income will be most damaging to American companies' oversea operations, cannot help but induce them to refrain from further investment or expansion and tend to dry up the flow of American capital into economic activities overseas. This action is diametrically opposed to the administration's pronouncements favoring economic

development of underdeveloped areas and particularly the support of the so-called alliance for progress program by American private capital investment.

Actually, these activities of the American business community should be encouraged by the tax incentive program embodied in the Boggs bill, H.R. 5, which passed the House of Representatives in the 86th Congress.

It is worth noting that H.R. 5, the foreign investment tax incentive bill, was adopted by the House by a vote of 195 to 192 on May 18, 1960, and that none of the Democratic members of the Ways and Means Committee voted against the bill. Supporters of H.R. 5 included the chairman of the Ways and Means Committee, the gentleman from Arkansas [Mr. MILLS], and the majority whip, the author of the bill, the gentleman from Louisiana [Mr. BOGGS].

The gentleman from Louisiana [Mr. Boggs] eloquently and forcefully advocated this stimulant to American capital investment overseas and among other things said the following—CONGRESSIONAL RECORD, March 8, 1960, page 4962:

Each year we hear we will be able to reduce foreign aid. We started the foreign program back in the time when General Marshall was Secretary of State. Many of you were here then. I say to you there has not been a year when the foreign aid program has not been presented to us with recommendations for greater and greater expenditures. If there is to be any answer to foreign aid—and I do not maintain that this is the only answer by any stretch of the imagination—but if there is to be any answer at all, the answer must come from the private sector of our economy. I know a lot of people believe this is just a scheme to make some already rich people richer, that this is a scheme for some people to avoid paying taxes. I can assure you that nothing could be further from the truth.

If this bill has any objective at all, the objective is to make it possible for the American entrepreneur, small, middle-sized, big, and biggest, if you will, to be able to take up where the American taxpayer's dollar leaves off. That is the only purpose of this bill. If it were not for that I would not be standing here talking to you about it.

Is it possible for this to happen? I do not know; nobody else knows. But I will tell you this, that if you removed from the world market the American investment that has been made in the world, you would have a severe and terrific depression in this country, because all we get from those investments are profits, not losses. Secondly, you would have a balance-of-payments situation, to which the gentleman from Wyoming referred a little while ago, which would make our present deficit look like a Sunday afternoon picnic; third, there would not be any way on earth to raise the amount of taxpayers' dollars that would be required to pick up where private enterprise left off in all these countries. This is just a matter of fact. These are not my words; these are the words of people who have studied this thing for months and years. I would refer you to the studies made by the Committee for Economic Development, the Rockefeller Brothers reports, the Hoffman study recently made, the Straus Committee report, the Boeschenstein Committee report, and many others.

The simple fact is that American capital has gone abroad to protect markets or to develop markets that would otherwise have gone to their competitors. As I said a

moment ago, one of our toughest competitors is the Communist bloc.

Mr. Chairman, I do not want to overstate the case for H.R. 5. It is not going to solve our world political or economic problems. It is not going to do away with foreign aid. It is not going to raise standards of living abroad by 100 percent in the next 2 years.

As I have said, it is essentially a modest piece of legislation. It will facilitate expansion of American private business overseas. It will bring greater equity in our existing system of taxation. It will contribute to the objectives that we have in fighting the cold economic war with our archenemies. H.R. 5 will help. It will not hurt.

The passage of this bill by this House will be a mark of the growing maturity of this country. It will reflect the need to bring our tax laws into conformity with our position in the world economy. It will be a positive step in the direction of accomplishing important national objectives.

It is a vote of confidence that the American businessman operating competitively under the American flag can meet the Soviet economic challenge.

Mr. Chairman, shortly there will come before us President Kennedy's proposal for vastly expanded authority in the Executive to decrease tariffs. Likewise, we will shortly be considering foreign aid legislation, including the alliance for progress. It is an anomaly that the administration will advance these two proposals involving vast transfers of our legislative authority to the executive branch of the Government and in the case of foreign aid, the appropriations of huge sums of tax money to fight the cold war, when the New Frontier is aiming a devastating blow at the contribution of the American business community in fighting the ideological battle with communistic imperialism.

Mr. Chairman, it seems to me more than a fortuitous circumstance that this same kind of double-think exists not only in the New Frontier, but in the legislative department of the AFL-CIO. Yesterday I received two letters from Mr. Andrew J. Biemiller, director of the department of legislation of the AFL-CIO. One letter with accompanying pamphlets urged my support of the so-called Trade Expansion Act of 1962, which has as one of its announced objectives, an increasing role for our American free enterprise system in international trade and commerce.

Paradoxically, the second urges my support of the tax bill that is now before us, H.R. 10650. One of the bases on which the AFL-CIO position favoring the tax bill is predicated pertains to the provisions of the bill imposing more stringent tax treatment on participation by our American free enterprise system in international trade and commerce. These tax proposals that the AFL-CIO espouses would impede the expansion of export markets for U.S. produced goods, would strike a devastating blow at the ability of the American business flag to survive competitively in world trade, and would constitute a political retreat for America in the face of the Communist threat to the free world survival.

Mr. Chairman, in his letter on tariffs, Mr. Biemiller espouses willingness to increase the exposure of our domestic markets to imports by reducing the protec-

tive tariffs that safeguard our markets for domestic producers and material. In contrast, Mr. Biemiller's tax letter would reduce the ability of American free enterprise to export and compete with the other industrialized nations of the world. These conflicting viewpoints urged by Mr. Biemiller in behalf of the AFL-CIO leave me somewhat confused, but confused only as to what the AFL-CIO really wants as its national objective—economic retreat or economic expansion. Mr. Biemiller has not succeeded in confusing me as to where I stand on the urgent issues of what America's posture should be in today's dangerous world.

I am categorically opposed to the policy of economic retreat and isolationism inherent in the foreign income provisions of the tax bill now before us. Based on firsthand study of international problems, I am convinced that American free enterprise and the people-to-people communications that it fosters in world commerce are greatly superior in fighting international communism to the reliance on a sterile policy of endless foreign aid through government-to-government channels, such as are implicit in this Treasury-sponsored tax bill and the New Frontier's foreign aid program.

Mr. Chairman, there are plenty of deterrents to American private capital investment overseas already. I have consistently urged that these deterrents be identified and eliminated or minimized.

Just recently, we witnessed the expropriation of vast amounts of American properties in Cuba. Similarly, one of the states of a presumably free and friendly country, Brazil, has confiscated a telephone company. These actions must give pause to any American manager of an enterprise responsible to his stockholders for the proper employment of capital and thus constitute a threat inhibiting the investment of American private capital abroad. These, however, of course, were actions of other governments, one of them being a Communist-dominated regime.

What possible excuse can we give for the action proposed here of imposing a punitive tax on foreign operations which is bound to undermine the confidence of the American business community in the stability of their Government's policy with respect to capital investment.

Even if the punitive provisions of section 13 of H.R. 10650 never become law, the very fact that they were seriously considered by the Congress and strenuously advocated by the New Frontier constitutes a threat of which the American business community is bound to be aware and in governing their policies and the management of their stockholders' funds, may well have widespread repercussions on the health of our entire economy. I hope the House of Representatives will forthrightly, speedily and vigorously repudiate the hate business philosophy implicit in these provisions.

In this context of international relations it should be observed that one of the most deplorable features of this tax bill is section 21, relating to treaty ob-

ligations. This section squarely overrides the principle of international law, embodied in section 7852(d) of the Internal Revenue Code, that the tax laws of the United States shall not apply in any case where their application would be contrary to any treaty obligation of the United States.

Section 21 raises a question of international law and elementary morality.

As of today there are 21 bilateral tax treaties in effect between the United States and foreign countries. If the Congress of the United States should ride roughshod over our treaty obligations, we must be prepared for retaliation by the other parties to these treaties.

More important still, the United States can ill afford the moral condemnation that will inevitably be forthcoming if it disregards international law and treats its treaty obligations as so many scraps of paper. Does this American policy of unilateral treaty abrogation provide any assurance to our Western Hemisphere allies of the sincerity of our intentions in regard to the much heralded alliance for progress? Just the opposite, Mr. Chairman. Does this policy of repudiating our solemn treaty obligations serve to strengthen our current endeavors to create new trade commitments among the countries of the free world? Again, Mr. Chairman, the answer is inescapably and emphatically in the negative.

Before the eyes of world opinion the U.S. Government has held itself out as the champion of morality in world affairs. We have repeatedly called the Government of Communist Russia to task as a treaty violator. How can we continue to take this firm moral position if we ourselves disregard treaty obligations when it suits our purpose to do so?

The principle of section 21 is thoroughly unsound. Its consequences could plague the United States in its foreign relations for years to come. It should be defeated; it should never have been proposed in the first instance.

The foreign income provisions of the tax bill will undermine and debilitate American business operations abroad and prevent private American capital from making the contribution to strengthening the free world through economic development which it otherwise could and would make without any cost to the American taxpayers. This is most unwise and amounts to killing the goose that lays the golden egg.

Mr. CURTIS of Missouri. Mr. Chairman, I yield 10 minutes to the gentleman from Ohio [Mr. BETTS].

Mr. BETTS. Mr. Chairman, at a time when the American taxpayer is hoping for a simplification of tax procedures, this bill offers only more complexities. In particular, the section on withholding of income tax on dividends and interest is the worst offender. If there are any doubts about this, one has only to read that portion of the bill which deals with this subject. He will find 46 pages of complex rules which, of course, will be implemented by an equal number of pages of regulations. He will certainly not find it a simple matter to understand all he is supposed to do.

No one condones the failure to include taxable dividends and interest in a tax return. No doubt there have been many violations. But it is fair to assume that only a small fraction of these failures are willful violations and that the great majority include omissions due to oversight or plain ignorance. The fact that there has been a campaign to educate the public supports this belief. However, I am of the opinion that this campaign has not been given sufficient time to work and has not followed basic considerations. Treasury officials say they have been making speeches on the subject and that banks and corporations have been advising their depositors and shareholders that interest and dividends are taxable. But the average taxpayer does not hear the speeches or take the time to read and study all the notices that come with corporation or bank statements. The simple device of a notice in red ink on the face of a 1040 form that these items are taxable would have involved little effort and would have effectively apprised millions of taxpayers of something they did not know or had overlooked. They would thus have been spared the complicated procedures of this proposal.

If on the other hand, as might be implied in the bill, the failure to include the tax on interest and dividends is a matter of fraud on the part of the taxpayer, then there is no way of guessing how many fraudulent refund claims might be filed. There is no provision for the issuance to the individual of any statement or receipt of the amount withheld from him. This means that the Internal Revenue Service would have no ready means of verifying claims for refunds. It is entirely within the realm of possibility that we could be in for a worse problem on refunds than we are on withholding.

Completing the individual income tax form 1040 today is a formidable undertaking. This year's form is entirely new and yet it is supposed to be a simplified form. Those who have already completed their form this year know just how simple it is. I suppose it is simpler than last year's form but making a complex form simpler still does not make it a simple form.

To cope with these proposed withholding taxes, the form 1040 has to be substantially changed. Lines must be added for reporting dividends not subject to withholding tax and lines must be added to report interest not subject to withholding tax. Lines must also be added to report interest on which tax has been withheld and lines to report dividends on which tax has been withheld. More lines must be added so the taxpayer can add up in one place those dividends on which no tax has been withheld or which he is not entitled to tax credit, and other lines must be added for other computations. On the dividends and interest on which tax was withheld, he must divide the total by four, add the result back in to ascertain 100 percent of his taxable dividends, and also to ascertain the amount of the credit.

The taxpayer's only way of learning whether tax has been withheld on particular payments of dividend or interest is just to appraise and study the payment he received. He then must consult very complex regulations, definitions, and instructions to form a legal opinion as to whether withholding was required on the particular payment. When he has reached this happy point, he is now ready to tackle the other schedules on the tax return with which we are all familiar.

In addition to these difficulties, the withholding provision contains the certain possibility of creating ill will between the taxpaying public and the Internal Revenue Service. Basically, as is well known, the bulk of the huge annual revenue collections of this country are collected under the self-assessment system, and this system survives only with the helpful cooperation of the some 60 million taxpayers who annually do battle with form 1040 and many other Federal tax forms and faithfully report their tax liability. But with this proposal there is going to be incessant controversy between taxpayer and tax collector so that taxpayers can secure the full credit for tax withheld or refund for tax overwithheld. Taxpayer indignation is also going to be extended to the payor of the dividends or interest.

Our whole economic system is based on credit. If the average American did not pay his bills, all commerce would come to a halt. Until I am given proof to the contrary, I prefer to believe that he will also pay his just taxes. There is no absolute exactitude in our system, and there can be none. There is an underlying basic honesty which has made the system work better than any other in the world. I am opposed to anything that will destroy this fundamental premise on which our collection procedures are based.

Let us recognize that this withholding should in a large number of cases be known as a proposal for overwithholding. The rate of withholding is to be 20 percent and there is no withholding offset for deductions and exemptions that are generally available to a taxpayer in computing tax liability. Thus, the administration-supported withholding provision which has been approved by the unanimous vote of the majority membership of the Committee on Ways and Means has a built-in guarantee that millions of taxpayers will be subjected to a denial of funds at the time they are due and to the inconvenience of having to ask the tax collector for money that belongs to the taxpayer.

Mr. Chairman, I regret to say that when the voting public of this country, including the more than 30 million taxpayers who will be exposed to the infernal nuisances of the withholding tax monstrosity contained in H.R. 10650 realize what has been inflicted on them, their acceptance of our voluntary system of tax compliance will be impaired.

There seems to be an odd misconception that there are just a few people in this country with enough capital to own shares of stock or to own interest-pro-

ducing investments. Let me warn you that there are more than 30 million. The number of persons holding shares of stock alone exceed 15 million. How many voters this represents I do not know. Certainly some of the 30 million are perhaps not of voting age—but they do have parents and other relatives of voting age.

If the shotgun approach of the Treasury withholding proposal were the only technique available for capturing unreported income and if the Treasury technique were workable, then perhaps it would be appropriate to give consideration to a withholding procedure. The fact is the Treasury plan is neither necessary nor workable.

For those of you who have been willing to listen, or to read, you have been shown by very simple facts that withholding taxes on dividends and interest are not necessary to close the underreporting gap of this type of income.

You have been shown in the House hearings and in statements on this floor that the Internal Revenue Service has today and has had for years the administrative tool to close this gap—but has not used it.

You have been told that the administrative procedures of the Internal Revenue Service are now well advanced into the electronic age. The Service has installed the automatic data processing machinery for handling taxpayers accounts which can trace underreporting of income automatically.

You have been shown that the Treasury came over to the Congress last year and begged for, and was given, the taxpayer account numbers bill as the last necessary tool it needed to make the automatic data process installation completely effective. The Commissioner of Internal Revenue himself has announced just within the last few weeks that on January 1, 1965, the Service's electronic automatic data processing operation will be fully operable on a national basis.

When the Treasury Department secured the enactment last year of the taxpayer account number bill, Treasury officials made representations to the distinguished chairman of the Finance Committee showing clearly that automatic data processing and taxpayer accounts numbers could close the gap on underreporting of income and the chairman referred to these statements on the floor of the Senate stating the following:

This legislation, the Treasury testified, would result in closing loopholes so that those who are now avoiding the payment of taxes would be compelled to pay by operating this new number system through computing machines.

He further said:

The tax revenue, the Treasury testified, would be increased by \$5 billion.

And he added:

The Treasury has told me it is the largest loophole closing bill that has ever been proposed.

It is thus clearly shown that the Internal Revenue Service has the working tools now in its hands to close any gap on the underreporting of dividends and

interest: Automatic data processing and the authority to use taxpayer account numbers combined with electronic equipment to trace, automatically, any underreporting of income.

It is beyond belief that instead of relying on this simple instant method of modern tools to check and correct any underreporting of dividends and interest, the administrative monstrosity of a poorly conceived withholding system is to be imposed as a millstone on the necks of both taxpayers and the Internal Revenue Service.

Mr. Chairman, the proposed withholding tax system has many infirmities that should be considered in determining a position on this important subject. Let me take you through just one of them.

It has been known from the time these withholding proposals were first sent to the Congress that the withholding tax system would collect tax from many millions of people who would not owe any Federal tax at all or would owe less than the amount of tax withheld.

It was known in advance and is known now that these people who will be the victims of overwithholding number in the millions and a large part of them are our senior citizens living on small pensions or annuities or on small retirement funds.

To make this bill politically more salable a gesture was made to try to alleviate the situation of the excessive withholding on these people and the perfectly unnecessary withholding on such things as the savings of children.

Very late in the day in the committee consideration of this bill, when the administration realized that it would have trouble with this overwithholding on the House floor, some exemption-certificate rules were added to the bill on a vote-seeking basis.

One rule provides that a child under 18 may file an exemption certificate with a withholding agent to escape withholding.

Another rule provides that a person over 18 can secure a partial withholding exemption if he certifies—and listen to these amazing words carefully—that he “reasonably believes that he will not—after the application of the credits against tax provided by part IV of subchapter A of chapter 1 other than the credits under sections 31 and 39—be liable for the payment of any tax under chapter 1.”

I invite your attention to the fact that the rule I have just read is for the little man. He is supposed to understand it.

Of course, the little man is a seasoned tax lawyer. He is quite an expert on part IV of subchapter A of chapter 1. And, of course, he knows by heart all about the credits under sections 31 and 39. Section 31 is only a full page of fine print. Section 39, on which the little man is expected to be an expert, begins on page 210 of the bill and prints three pages of complex rules.

This is all the little man has to read, understand, and take responsibility for in signing his exemption certificate to escape withholding. If he is a seasoned tax lawyer or a Member of Congress he can probably handle the problem and sign his name to the exemption certificate form with some sense of assurance.

But a surprise is in store for him. He was only reading the full contents of page 197 of the bill. He should have studied closely page 199. He would have then discovered that this exemption certificate is no good as to interest on bonds, debentures, notes or certificates of indebtedness issued by a corporation. Nor is his exemption certificate any good as to interest on savings in something called a transferrable certificate or share in a savings bank or building and loan association or that kind of an institution. He will also be shocked to learn that his exemption certificate is meaningless as to interest-paying obligations of the United States—Government bonds. Further, he will discover that if he had followed the Government's urgings over many years and invested in Government savings bonds, he will have to work out a separate exemption certificate every time he cashes in a baby bond.

As to whether his partial exemption certificate is worth anything if he holds a joint account with his wife is an answer he will not have until the Treasury issues a multipage regulation to cover joint accounts.

Such is one of the items of partial—and I quote—“relief”—unquote—for the little man from this withholding tax system.

Then the bill has another great relief project—and again I must quote the word “relief”—for some more of the little men. This one is for the little man who will owe some tax, but less than the 20 percent tax withheld, and who “reasonably expects” not to have more than \$5,000 of gross income—or \$10,000 if he is married.

This part of the bill which prints up a mere 3½ complex pages advises this little man that he can get a tax refund every quarter if he will don his hair shirt, take his tin cup in his hand, and crawl to the Federal tax collector's office begging to get his own money months after it is due him. To secure these refunds every quarter through the red-tape mill of a Federal agency this little man has to be real sharp. He has to fill out a tax refund claim form—not yet designed—which will be worked out under these 3½ complex pages of statute—and probably 10 times that many pages of regulations—and in that claim for refund he must compute something called a refund allowance as of the time the claim for refund is filed. His refund allowance takes a page of tax bill to define.

All this little man has to do to work out how much refund allowance he must claim is to figure, and listen carefully to this from proposed section 3484 and its multiple subdivisions. His refund allowance is to be—

The excess, if any, of—

(1) an amount equal to 22 percent of—

(A) the total of the deductions which, on the basis of facts existing at the time the claim for refund is filed, such individual would be allowed for the taxable year under section 151 (relating to deductions for personal exemptions), plus

(B) in the case of an individual who, at the time the claim for refund is filed, reasonably expects that he will be allowed a credit under section 37 (relating to retirement income) for the taxable year, the amount which, at such time, such individual

reasonably expects to be the amount of his retirement income (as defined in section 37 (c) and as limited by section 37(d)), for the taxable year, less—

Now add this to what I have just read to you—he must now compute—

(C) the amounts (other than amounts on which tax is required to be deducted and withheld under this chapter) which, at the time the claim for refund is filed, such individual reasonably expects to be includible in his gross income for the taxable year; over—

At this point—if he is still able to speak—he finds the answer to the mystery to what that word “excess” is all about. It is the excess of everything I have read to you over—

the amounts of tax with respect to which an allowable claim for refund has been previously filed.

This is the key to the system for simple, quickie refunds to the little man on whom tax has been overwithheld. He is supposed to battle these complexities and a Federal agency to get the small amount of money he needs for a daily living which was withheld from his interest and dividends.

From the quotations I have just given you from the statute you will note that even the bill is not optimistic about a quick refund. Those quotations which talk about the claim for refund the little man has filed in previous quarters does not talk about refunds that have been paid to the little man. The bill uses the word “filed” and talks about a refund claim filed, not a refund claim which has been paid.

Now this provision of the bill providing for these quickie refunds for the little man also shows tender solicitude for children on whom tax has been overwithheld.

It has a solicitous provision with the curious title “Individuals Not Eligible for Refunds,” and this clause provides that a child is not eligible for this simple administrative relief “unless at the time the claim for refund is filed, he—the child—reasonably expects that no deduction would be allowed for him under section 151(e)(1)(B) for the taxable year of his parent.” This reasonable expectation has to be entertained by the child under the language I have just read to you and that reasonable expectation has to be worked out from the child's knowledge of section 151(e)(1)(B). That section prints in the existing revenue laws only two long closely printed pages.

Will the Commissioner of Internal Revenue accept the reasonable expectation of an infant in arms, or that of a child aged 2, 4, 6, 8, or 10? What will the regulations say as to the age at which a child can develop enough competence to reasonably expect what will be allowed for him under the two printed pages of section 151(e)(1)(B).

I have just given you a small, and a very simple, sample of the mumbo-jumbo that is to be inflicted on the voting public by the 45 technical pages of this bill imposing the withholding taxes. One could take any other topic in the withholding tax area and give you an equally illuminating sampling.

These withholding taxes are not to begin until 1963—which is conveniently

after the elections in the fall of 1962. The public, therefore—and by public I mean the 30-odd million citizens of this country who vote and on whom this monstrosity is to be inflicted—will not know what is happening to them during the elections this coming fall. But they will find out in 1963 and they will feel it all during 1963 and all during 1964. And I emphasize—this public I am talking about is not a tiny little minority of rich capitalists. It is 30 million American voters spread through every State in the country. This is not a “soak the rich” provision; it is a “soak most of the voting public” provision—a “tax overwithholding” provision.

Witness after witness appeared before the House Committee on Ways and Means and revealed all these truths time and time again and everything they said has been swept aside or ignored by the administration and the committee majority. These witnesses might as well have stayed home for all the value their appearance at the hearings had in advising many Members of this legislative body.

Recently there have appeared in the CONGRESSIONAL RECORD desperate statements seeking to defend the administration's untenable position in favor of an unworkable overwithholding system and against effective use of automatic data processing machines and its taxpayer account number system in lieu of this unwise withholding system.

I would remind you again, as was cited on page A2092 in the CONGRESSIONAL RECORD for March 20, 1962, that as recently as last fall Treasury spokesmen told the distinguished chairman of the Senate Committee on Finance that the taxpayer account number system, coupled with automatic data processing, would, to quote again the chairman's statements on the Senate floor, “result in closing loopholes so that those who now are avoiding the payment of taxes would be compelled to pay by operating this new number system through computing machines,” and that “the tax revenue, the Treasury testified, would be increased by \$5 billion”; and further, “the Treasury told me it is the largest loophole closing bill that has ever been proposed.”

But now we are told on this floor on March 22 in a speech supporting the administration position and quoting Treasury officials that the automatic data processing and account numbers system is just about so much junk. That it is uneconomic to use it to identify delinquent taxpayers or for purposes of closing any gap on the underreporting of income on tax returns.

If it is this bad and this useless, why all this administrative work and huge appropriations to set it up? Why has it been pointed to with so much pride and fanfare?

If the dividend and interest information returns on Form 1099 are also just so much junk why are people forced to the expense of filing them by the hundreds of million and why are they to be fed into the automatic data processing machines? Why are all paying agents

now being compelled by law to put each taxpayer's account number on these Forms 1099?

Why are we told—despite the Treasury's quoted position of just last fall that the taxpayer account number bill was the largest loophole closing bill in history and that this plus the automatic data processing system will increase revenue by \$5 billion—and why are we told in this March 22 speech on page 4382 of the RECORD words to the following effect:

First. That what is really missing is \$800 million of revenue, not \$600 million.

Second. That automatic data processing plus account numbers can only catch up with \$200 millions of this.

Third. That even automatic data processing will cost \$27 million of administrative expense.

If these administration-inspired contentions are correct, it looks like an admission that automatic data processing is just about 75 percent defective.

The Treasury knows, and it knows very well, that the withholding tax system will not—I repeat not—add to the tax rolls the name and address of a single tax dodger.

The Treasury also knows, and knows very well, that its automatic data processing machines, when fed the information returns on form 1099, will add—I repeat will add—to the tax rolls the names and addresses of people who have received dividends and interest—and that the names and addresses of the tax dodgers will then automatically go on the tax rolls. They will be right there included with the names of the honest people. The machines will have caught the dishonest or careless man without harassing the honest and careful man.

The Treasury knows that this proposed withholding tax system which might collect \$1,000 from the tax dodger who actually owes \$5,000 tax on his dividends or interest will not collect the missing \$4,000 and will not reveal the name and address of the tax dodger. It is true the automatic data processing machines may not automatically collect that \$1,000 but they will identify the tax dodger who owes the \$5,000 and make the collection of the entire amount possible. The Treasury has to chase him anyway to get the \$5,000—which is no more work than chasing him to get the \$4,000. Now he is identified and out in the open.

Apparently the face of this administration is so deeply committed to imposing this overwithholding tax on 30-odd million taxpayers, that it has to resort to the amazing technique of deprecating and complaining about the inadequacies and weaknesses of its automatic data processing tool. It just does not dare admit that it already has the very administrative tool that makes a dividend and interest withholding system unnecessary.

In the administration's attempt to gloss over the needless hardships and inequities that will result from this Treasury proposal, we are told that the problem of overwithholding has been much

magnified—that it is not really much of a problem. This we are told, despite the many simple truths only one of which is that a 20-percent withholding rate is automatically 10-percent overwithholding on all taxpayers who are in the 20-percent bracket. The effective rate, we all know, of the 20-percent bracket is only 18 percent because of the standard deduction.

Then we are given the same old phrases which attempt to parallel wage withholding with withholding on dividends and interest. But in the midst of these phrases you are not reminded of some simple facts that show there is no basis for saying that they are alike.

For example, an individual usually has one employer with whom he has a direct personal relationship, and no one has any trouble figuring out what the word “wages” means. In contrast, recipients of dividends and interest are nearly always just strange names on a paying agent's mailing list. And in this bill it takes four pages of complex technical rules to define the different kinds of dividend items subject to withholding. These pages are supplemented by other pages of exceptions or refinements.

It is not so simple as the Treasury and the committee majority would lead you to believe.

The Treasury officials who now give us warm assurances about the simplicity of withholding taxes and about the glories of the exemption certificate system apparently have done an about face since these same Treasury officials testified before the Committee on Ways and Means in public hearings last year and made the point that the withholding tax system would be unduly complex if payees were permitted to file exemption certificates to claim exemption from withholding tax. These Treasury officials overlook the fact that they recommended against any use of exemption certificates just last year. You can find these conflicting Treasury recommendations in the Treasury statements on pages 11, 39, and 277 of the Ways and Means Committee printed hearings.

The statement of my good friend from New York also shows that Treasury officials are disturbed by having to find some current sophistries to avoid the impact of another truth spoken in the past by a senior official. The present Deputy Commissioner of Internal Revenue had stated in a public speech:

One of the important changes needed to make the information system an effective substitute for withholding is to obtain taxpayer account numbers on all forms 1099 and similar documents.

This was not too long before Congress passed the taxpayer account number legislation.

Not only will these taxpayers find their accounts completely scrambled by a no-receipts withholding system, but they are going to find the new form 1040 which must be designed to cope with all this gobbledygook a massive “inconvenience” to “experience”. They are going to have to study numerous pages of instructions, and tedious legends on

their forms 1040, to cope with the mystery of which dividend and which interest payments they receive fall under the withholding system and which do not. And then they will have to compute their refunds and establish their entitlement to them. Yes—certainly they “may experience inconvenience.” Let us not be deceived by the blandishments of the Treasury that conceal a design to harass our taxpayers and collect taxes that are not due.

What I have said so far, as has been the case with the many full exposés of this unbelievable withholding tax proposal, will be brushed aside by the administration’s propagandists. They have been feeding all of you and the press a steady patter of clichés erected around their theme song—withholding taxes are necessary to catch the cheaters, the tax dodgers.

But pause for a moment to think of the realities here, the real facts.

Over 30 million people are going to have this bumbling system fastened around their necks like a millstone.

You know, I know, and the administration knows, that these many millions of people are not cheaters—are not tax dodgers. Basically they file honest tax returns and report their dividend and interest income.

You and I know that it is the tiny fraction, the small fringe of taxpayers who are the cheaters and whose income tax returns are open to question.

But over 30-odd million people are going to be punished for the sins of the very, very few. These innocent millions are not going to like it when they have to pay taxes that may not be due to catch a few who may owe taxes.

And why is this bumbling monstrosity to be visited upon them?

Because, as I have said, the Treasury Department and the Internal Revenue Service are now seeking to discredit as a solution a simple new modern electronic tool that is now being installed to aid tax enforcement. I refer, of course, to automatic data processing.

Do you know that for many, many years payors of dividends and interest—called paying agents—have been required to file with the Internal Revenue Service information returns listing the amounts of dividends and interest they pay and listing the names and addresses of the payees on forms 1099?

And do you know that these paying agents file nearly 200 million of these forms 1099 each year?

In recent years the Internal Revenue Service has stepped up the associating of these information returns with the tax returns of the people to whom the interest and dividends were paid. This “matchline process” will be strengthened under ADP. This is a technique the service has now in its hands for checking failures to report dividends and interest. This is a tool it will not use because the administration has decided to urge a more costly withholding tax system which will certainly cost the Treasury itself \$25 million a year in direct administrative cost, plus untold millions of dollars representing the tax deductions for the administrative expense

piled on paying agents and taxpayers, plus untold millions of dollars lost through the absolute impossibility, built right into this bill, of checking the tens of millions of credit and refund claims this bumbling system will generate.

None of us is in favor of tax avoidance—and all of us want the tax dodgers brought to heel. But it is so easy, and so simple, and so inexpensive to close any gap on reporting of dividends and interest with simple existing administrative tools rather than resorting to the cumbersome withholding system proposed by this bill.

Why does the Treasury want to arouse the ire of so many millions of taxpayers? Why does the Treasury want to make the already complex individual income tax Form 1040 twice as complex? Why does the Treasury value so little the taxpayer goodwill so important to the successful operation of our income tax self-assessment system? Why does the Treasury insist on further complicating our already incredibly confused income tax structure?

The answer is simple: Once having made the mistake of proposing withholding taxes the administration cannot afford to lose face by admitting its mistake—by conferring error no matter how potent it may be.

In closing, I would make the point mentioned earlier that these 30 million American taxpayers who will be adversely affected by this bill represent not less than that many voters. They are the voice of public opinion, and public opinion is still a strong force in this country.

The millions of people may not know today what is about to happen to them—and they will not know until this withholding tax monstrosity starts grinding at them in the year 1963—when the 1962 elections are safely behind.

These millions of voters are going to grow angry when they find their accounts are confused; when they learn that money they have budgeted for necessary living expenses never reaches them but has been diverted into the Federal till; when they learn that to straighten out their accounts, to secure their refunds, to establish their credits, they are going to have to do business with a myriad of complex new forms and rules—and that for securing credits and refunds they are completely at the mercy of the whims of the redtape mill of the Federal Government.

They will not feel the impact for the fall election of 1962 in any big way, because the overwithholding tax does not fall on them until 1963. But beginning then these 30 million tax-bruised Americans are going to make their feelings felt at the polls at every opportunity. And that is a lot of votes.

When the questions come to you—“How did you vote and why?”—what are you going to tell them?

I know you will be honest and tell them the truth.

The truth you will tell them is the administration’s economists and professors dreamed up an unwanted gadget called the investment credit for busi-

ness. Having no business experience these economic planners ignored the national need for depreciation reform—campus economists were certain the investment credit gimmick would save the country. But it cost money. Who is going to pay the freight? Well the administration—the Treasury and the majority party in the Congress—agreed this withholding tax on the little man was a good idea to raise most of the money to pay the freight of the economists’ dream boat, the investment credit. The little man must produce money to pay this subsidy to the businessman.

You might go further and tell them that when the administration first came to Congress to seek the investment dreamboat it was to be a 15-percent dreamboat. Then in the middle of 1961 it was reduced to an 8-percent dreamboat. Then the spokesman for the economists and professors said that a dreamboat credit of less than 7 percent was worthless for their grandiose schemes.

The 8-percent dreamboat was disclosed to the world by the committee as recently as March 12, 1962. And then, although nearly a year had been spent on celebrating and building the dreamboat, suddenly a few days after March 16 it was discovered that the country really did not need an 8-percent dreamboat credit. One much less would do the job.

But since the spokesmen for the economists and professors had said repeatedly that less than a 7-percent credit was not a good dreamboat, the dreamboat was sliced down to look like a 7-percent dreamboat; but inside the dreamboat a \$100,000 figure was cut to \$25,000—this the voters cannot see easily—and then a 50-percent figure was cut to 25 percent—this is even harder for the voters to see—and now we have just about a 3-percent dreamboat, which is certainly useless now for the great economic revolution it was supposed to create. But face must be saved, and the public interest is quite unimportant.

So now our 30 million voters are to take the overwithholding tax licking to supply the funds to just give a small bonus—an outright subsidy—to some business, mostly big business. Wait until the millions of voters wake up to this.

One other observation may be in order and that is the treatment of many diverse proposals in one bill which has to be voted on as a single issue. Including all the items with respect to income earned abroad as one, I count nine separate and distinct provisions. I find it difficult to rationalize a situation which prohibits a vote on each issue separately. I know the answer is that it is next to impossible to treat the bill otherwise. But it is hardly fair that the fortunes of one group of taxpayers has to rise or fall on the merits of the proposals affecting another. There is simply no community of interest between a farmer’s cooperative and the subsidiary of a U.S. company doing business in a foreign country. And yet, with respect to the tax treatment of each in this bill, we are asked to vote for both or against both.

H.R. 10650 is objectionable because it affects so many groups with so many varied interests and requires that they be considered as one. The omnibus bill is customary practice in the House but in this instance it reveals in a harsh manner the inequities that it can produce.

The minority motion to recommit offers the only possibility of remotely removing any of these inequities. Unless the motion is carried, the bill should be defeated.

(Mr. BETTS asked and was given permission to revise and extend his remarks.)

Mr. MILLS. Mr. Chairman, I yield 5 minutes to the gentleman from Pennsylvania [Mr. DENT].

Mr. DENT. Mr. Chairman, I rise to support this legislation because I feel that it contains certain tax reforms that have been long overdue.

I cannot be accused as some have been of supporting the so-called Boggs bill, H.R. 5. I think I can speak from the opposite viewpoint. I said then, if you will remember, that time would cure everything, that if you lived long enough they would be back in here sooner or later recognizing the dangers I pointed out. I happen to be one of those who believes that foreign investments in American branches and production facilities have done more to curtail the growth of our domestic economy than any other single factor.

This is no time for a detailed discussion of the relationship of foreign investments to imports and exports and the depreciating effect of low wage competition of foreign-based American facilities in competition with domestic production for both our domestic market and our foreign market. It may come as a surprise to most of you that as far back as 1954, 30 percent of all of the imports into the United States came from American investments overseas. It seems somewhat strange to me how one can plead for tax advantages for foreign investors while at the same time depreciating the effect of investment credits. We in the United States may have a main plant in one State and have subsidiaries in other States. Whether we have different tax bases in these States makes no difference when it comes to assessment of the Federal tax. We in the United States cannot expand our facilities unless we do so out of tax-paid dollars. Just as the chairman of the Committee on Ways and Means so ably said, instead of criticizing this feature which is trying to equalize and put on the basis of equity foreign investments by American companies, we should be demanding that American investments here in the United States receive at least the same treatment. We are not asking for any more. We must realize that you cannot give an incentive to foreign investors with American capital and take away incentives in the United States.

During the past year I have been privileged, although you would not know it, to serve as chairman of a committee studying the impact of imports and exports on our employment. If you will take the time to read the printed hearings—you

probably will not have time—you will note that the question of tax haven industries overseas creates by far the most damaging impact upon our domestic economy. Time has not been allotted to me to give you the complete story, but let me for a moment give you some detailed figures that have been put out by our own Department of Commerce.

In the last 7 years investments in Western Europe have amounted to \$5,141 million. These investments returned to the American investor \$2,261 million. Here comes the real crux of the whole program. We are told it is proper to give out-of-country investors the right to invest profits in underdeveloped countries as an aid to those countries.

Let us see how far this aid has gone. In the underdeveloped countries in the last 7 years Americans invested \$5,552 million, but they took out of these same countries a profit of \$8,794 million. I do not believe that bleeding red on the floor of this House is going to convince any sober-minded American that American investors are interested in anything except profit. That is what investments are for, whether they are made here in America or they are made in foreign countries. If you tie investments overseas with a complete embargo on the products of those plants coming into the United States, you might have a reasonable base upon which to place an argument that we should help underdeveloped countries with our private investments.

EXODUS OF AMERICAN INVESTMENTS AND PRODUCTION OVERSEAS

The proposal to tax overseas earnings same as U.S. domestic earnings means nothing when profits overseas can be what they have been:

Dollars invested abroad and the income the United States gets back

[In millions of dollars]

	Investment	Income
Investments in Western Europe:		
1956.....	516	280
1957.....	631	311
1958.....	422	325
1959.....	750	393
1960.....	1,322	427
1961.....	1,500	525
Total.....	5,141	2,261
Investments in underdeveloped areas:		
1956.....	1,270	1,406
1957.....	1,187	1,549
1958.....	780	1,429
1959.....	707	1,386
1960.....	608	1,474
1961.....	1,000	1,550
Total.....	5,552	8,794
Investments in Latin America:		
1956.....	826	800
1957.....	800	915
1958.....	317	653
1959.....	347	600
1960.....	267	641
1961.....	500	770
Total.....	3,057	4,379

You will note that the investments total, for this period alone, \$13,750,000,000. Considering the ratio of 3 to 1, in cost differentials, between the United States and the Common Market, the \$5 billion spent in Europe represents ap-

proximately \$15 billion that would have had to be spent in the United States to build the same facilities; the figure in the underdeveloped countries is even more dramatic. It would have required a minimum of \$32 billion in domestic investment.

Is there any wonder the opponents of this legislation who are in the international trade profits race have steamed up the little investors dividend receivers to kill the bill before us.

Of recent date, there has been a series of articles appearing under the caption of "Loopholes, Inc." The extent of foreign investments and their impact on the American economy, makes it imperative that this Congress pass this legislation at this time. I would suggest, also, that the Committee on Ways and Means pursue its study even further in this area of tax dodging. In this regard, I would like to quote from the Daily News, of New York: **LOOPHOLES, INC.—FAT CORPORATIONS AGILE AT DODGING THE TAX SQUEEZE**

(By Joseph Martin and Kermit Jaediker)

NO. 1

WASHINGTON, March 5.—While Joe Blow sweats and schemes to lop a measly 25 bucks off his Federal income tax and then stays awake nights wondering if maybe he didn't go a little too far, a sizable number of American corporations are savings hundreds of millions yearly through one of the sweetest collections of tax dodges in or out of the book.

And they're sleeping quite peacefully nights.

This is because they have something Joe hasn't got and probably never will have—gall. Plus a highly paid array of brains behind them. Plus a little thing called a foreign subsidiary. No matter how bright Joe is, or gutsy, on a salary of five or six grand a year, he just can't go around setting up foreign subsidiaries.

The News has taken a deep, searching look into this phase of business and what it found proved highly fascinating. Also educational.

And now we're passing it all on to you, Joe, just to let you know that, in spite of what the pessimists say, there are still people with ingenuity and pluck and that with such attributes behind them, plus a good hunk of cash, a man can really go somewhere. And we don't mean jail.

The Internal Revenue Service, headed by Commissioner Mortimer M. Caplin, is all wrought up over these dodges but most of them lie within or on the razor edge of the law, and even in cases where they seem to cross the edge, it's up to Uncle Sam to prove there was criminal intent behind them.

This is difficult. The Treasury Department, which drafts legislation in such matters, has been trying desperately to plug up loopholes in the law. But this is difficult, too.

THE GENIUSES AND THE DODGERS MULTIPLY

The fun all began less than a dozen years ago.

What led to it was the Government's policy to encourage investment in Europe. Investment grew and then some unknown tax genius got an idea and investment boomed. The idea was some sort of tax dodge.

As time passed and more geniuses got into the act, the dodgers multiplied, flowered. Frills were added. The trickery developed to a point where the job of organizing it and putting it into motion became a pretty big thing, almost an industry.

The dodgers, or "tax avoidance devices" as the Government cautiously puts it, all hinge on the establishment of a foreign subsidiary. Government sources estimate that there are

around 20,000 foreign corporations owned directly or indirectly by U.S. shareholders, and most of them are getting juicy tax breaks—but there's nothing fishy about it.

The fishy stuff is pulled by an untold number of Johnny-come-latelies who suddenly discovered what a tax bonanza foreign trade could be, if you had the gray matter and the daring.

To savor their shenanigans to the full, you must first understand precisely what the corporations are seeking to avoid—the 52-percent corporation tax exacted by Uncle Sam.

This is a pretty agonizing bite. For instance, if Loopholes, Inc., earned a modest \$2 million last year, it had to fork over \$1,040,000 of it to the Government.

TAX HAVENS, WHERE THE BITE IS LIGHT

It so happens, however, that there are other nations in the world that don't bite so hard. These are known, quite aptly, as tax havens. Panama won't tax a corporation a red cent if it doesn't transact business there. The same goes for several other places, including Bermuda, Nassau, Venezuela, Liechtenstein, Liberia.

Switzerland's cantons, or provinces, charge a tax but it's laughably small, not more than 8 percent.

So Loopholes, Inc., fed up with that 52-percent horror, sets up a subsidiary in one of these low-tax or no-tax countries. It goes without saying that good old Loopholes must be engaged in exporting or importing. Most of these companies are situated on the Nation's east and west coasts, with the greatest concentration in New York.

There are, basically, two types of foreign subsidiaries. There's the bona fide type that actually does something for a living. It may sell the parent company's products, or manufacture them, or assemble them, or mine ore.

And there's the type that twiddles its thumbs.

This type is a dummy, known in the trade as a shell. And that's just what it is—an empty shell that produces nothing, sells nothing, assembles nothing, yet still has a vital function: to keep those taxable corporate millions out of the hungry fingers of Internal Revenue.

THE SHELL GAME, MOST FLAGRANT OF THEM ALL

Some of the bona fide subsidiaries aren't above a little tax finagling, but let's deal with the shell game first. It is the most flagrant finagler of all.

The machinery for acquiring a subsidiary is all laid out for Loopholes, Inc., by some smart tax consultants. They advertise their wares in come-with-us-now-to-a-land-of-sunny-skies-and-no-taxes brochures that read as enticingly as the booklets of a steamship company touting luxury cruises to Hawaii.

These brochures never, never mention that dirty word, "shells." But the Government strongly suspects that after the company has read the booklet and loved what it read and gotten together with the consultant, somehow the structure of a shell takes form; in some instances, anyway. After all, most tax consultants do organize bona fide subsidiaries.

Let's say the shell is to be set up in Panama.

For a fee of around \$500 to \$1,000 a Panama lawyer or CPA establishes a corporation called El Fakero. Its office is his office. By law, all these corporations must be proclaimed by signs on the facade of the building and it's quite a sight to see, in Panama or Nassau, a modern office building whose front is plastered with signboards as far up as the second or third story.

In addition to the initial fee, Loopholes, Inc., must get up licensing fees of about \$250 a year. But look what Loopholes gets for its dough:

In pre-Panama days, Loopholes had a big customer in London. Loopholes would sell London four or five shiploads of home appliances a year. For the sake of simplicity, let's say the London firm paid \$100,000 a cargo, and that the cargo actually cost Loopholes \$50,000 to produce.

FIFTY GRAND PROFIT, BUT OH HOW IT'S NIPPED

That meant Loopholes made a profit of \$50,000 per cargo. But Loopholes didn't keep the 50 grand; there was Uncle Samuel holding his mitt out. Out of that \$50,000 in earnings, Loopholes had to pay \$26,000 in U.S. taxes.

But that was in pre-Panama days. Now, on paper if not in actuality, Loopholes sells the same cargo to its own subsidiary, El Fakero, at slightly above cost, \$52,000; it could actually sell at cost, but that might be a little too raw. It's got to show it's making some profit.

El Fakero sells the same cargo to London for the usual price of \$100,000. Thus El Fakero garners a profit of \$48,000. If El Fakero were in New York, where Loopholes is, it would have to pay a 52 percent corporation tax on the \$48,000, but El Fakero is in Panama, where there is no tax. Uncle Sam, who used to collect more than half the profits of Loopholes' export business, now collects nothing.

In other words, Loopholes siphons its profits from the tax-happy United States to taxless Panama. So far so good. Now, there's a new problem: How to get that 48 grand back to the United States. Under law, once the earnings land in the United States, they become taxable.

At this point El Fakero gets kind to papa. It lends Loopholes the \$48,000. Loans, of course, are not taxable here. El Fakero even garnishes the dish by charging Loopholes, its own daddy, 6 percent interest on the loan. Daddy-O isn't sore. When Pop's tax expert fills out the old income tax blank, he puts that interest down as a deduction.

What this boils down to is that the \$48,000 profit has finally come home, pure profit, yet taxless, because now it isn't profit but a loan.

AND THE SHIPMENT NEVER REACHES PANAMA

Remember us saying a little while ago that Loopholes sells the cargo to El Fakero on paper?

Actually that shipload of appliances never goes to Panama. It goes, as usual, direct from New York to London. And El Fakero doesn't really send the profits back to Loopholes. It never gets the profits. The profits are sent directly from London to New York.

The entire transaction, selling to El Fakero, reselling to London, that phony loan—all this is performed on paper at the home office.

After all, El Fakero couldn't possibly receive a cargo, or ship it. El Fakero doesn't exist. It's just a name on a document of incorporation lying in the filing cabinet of the Panama lawyer or CPA who set El Fakero up. A ghost with a slight Spanish accent amiably thumbing its nose at the U.S. Internal Revenue Service.

NO. ■

In a long desk-studded room in one of the New York City district offices of the U.S. Internal Revenue Service, trained agents are going over income tax returns. They're not the familiar white 1040 forms issued to most citizens. They're the blue 1120 forms issued to corporations.

An agent studies the return of an outfit we'll call Tinhorn, Inc., and suddenly his eyes glow. It is the same glow that lights the eyes of a homicide squad detective when he glances at a window at the scene of a murder and spots a fingerprint.

The clue the Internal Revenue man has spotted doesn't concern anything as drastic

as murder. It may not even be illegal, in the strict sense of the word.

But it is tricky as hell, a gizmo designed to keep Uncle Sam from taxing a chunk of Tinhorn's profits, and if the Government can get the goods on Tinhorn, Tinhorn will have to pay through the nose.

COSTS HIGH, PROFITS LOW: SUSPICIOUS

The clue lies in the ratio of the magnitude of Tinhorn's operations to Tinhorn's profits. If the scope of operations is tremendous and the cost high and the profits curiously low, the agent smells a foreign subsidiary set up to avoid the American 52-percent corporate tax.

The agent turns to page 3 of the return. Item L asks if the corporation has a foreign subsidiary and Tinhorn has left this question blank. This could be an honest error of omission. But the agent is suspicious.

If he has time to handle the assignment, the agent grabs his hat and hurries up to the office of Tinhorn, Inc. He meets Frank Tinhorn, the president, and gets right down to cases.

"You own a foreign subsidiary?" the agent asks.

Tinhorn goes a little gray, but he doesn't dare get caught in an outright lie. He admits he owns one in a country in Latin America.

"How come you didn't mention it on your income tax form?" demands the agent.

Tinhorn forces a smile. "Didn't I? It must have been an oversight."

The agent has hit paydirt. The country where the subsidiary is situated is notorious for its shells—ghost companies that exist for the sole purpose of preventing the United States from collecting the 52-percent tax on the parent company earnings.

"Let's see your books," says the agent.

Here he comes a cropper. The books may contain only vague references to transactions with El Spooko, the subsidiary, or there may be two sets of books. The set Tinhorn shows the agent says nothing.

MUST CLEAR IT WITH STATE DEPARTMENT

The only possible source of information is El Spooko. Since the agent can't be spared for a prolonged investigation of Tinhorn's dealings, his office phones the Office of International Operations of the Internal Revenue here in Washington, and they assign a man to the job.

This agent, before boarding a jet, must first see someone in the State Department. State might very well reject his request to go south of the border. The country where El Spooko is located may be conducting delicate diplomatic negotiations with the United States and it just wouldn't do right now, old chap, to have an American agent gumshoeing around down there.

However, if the striped-pants boys see no obstacles, the agent flies to the city where El Spooko was incorporated. It's a shell all right—no staff whatever.

Its office is the office of the local attorney who set El Spooko up. As a rule, this worthy tells the agent to go scram, or the Spanish equivalent thereof. But there are other avenues of inquiry.

Internal Revenue agents whom we interviewed declined to disclose the techniques they use in tax-haven countries to get at business records or loosen up tongues, but it's no secret that employees in banana republics often have greasable palms.

The agents did not deny that they had friends who would not hesitate to sneak, after dark, into a government building.

Next morning the agent would awake to find an unmarked envelope in his mailbox and some very interesting evidence in it, along with a curt note to please, senior, hurry up and photostat the contents as they must be back in the files in an hour.

The evidence might consist only of some names and addresses, but they are leads and the investigator continues his inquiry.

Some of these investigations last as long as 2 years. But even if the Government thinks it finally has a case against Tinhorn, it has to prove it in court. And that isn't always possible.

If the Government wins out, then Tinhorn must come across with taxes, plus penalties and interest, which could add up to millions.

The most productive source of information is the informer.

There's nothing more heart-warming to Internal Revenue than to have the book-keeper of a New York corporation walk in and announce that he just got fired and that he is now going to retaliate by squealing on his boss who runs a shell subsidiary. He might even show the Government the company's books.

Or, maybe Tinhorn's wife has learned he's keeping another woman. That makes wifey a potential informer. And the same goes for the mistress, especially when Tinhorn gives her the gate.

CANARY TREATMENT, BELOW THE BORDER

The informer is rewarded with up to 10 percent of the taxes collected as a result of his or her information.

Last year the Internal Revenue Service paid \$548,914 in rewards to 706 pigeons for information resulting in the collection of \$12 million from all kinds of taxpayers. This dough, by the way, wasn't exempt from Internal Revenue Service. Every pigeon must pay income tax on the profits of his squeal.

Business chiselers operating shell subsidiaries seem to take a squeal in pretty civilized fashion, at least in the United States. There is no record of any informer ever getting knocked off or pushed around here.

The chiselers get a bit less inhibited, though, when they're handling a canary below the border. There, for example, a man suspected of blowing the whistle on an American firm was suddenly whisked out of bed one night and grilled. He denied everything.

He was suspended by his hands outside a window, nine stories up, and that got him talking. He unloaded all the info he had given an American agent, with the result that the U.S. company was able to take measures to cover its tracks.

THEY PLAY TRICKS, THE BIG AND THE SMALL

Corporation tax abuses committed with the help of subsidiaries are so new, in some instances, that Commissioner Mortimer M. Caplin, boss of the Internal Revenue Service, has developed a special training course to make enforcement personnel completely hip on tax avoidance patterns to divert abroad income that should be taxed in the United States.

"In recent months," Caplin told the News, "the need for a more vigorous tax enforcement program in the international area has been strongly emphasized."

"Among the many approaches used are sham corporations with no real business purpose or function, unrealistic sale or purchase prices in transactions between the domestic company and its foreign affiliates, and failure to properly allocate various expenses."

"We have discovered that these devices are used by all types of taxpayers, regardless of size or reputation, and many cases involving large corporations are now under active audit in the field. Undetected, these schemes cause a loss of revenue to the United States and create competitive economic inequities through tax dollars saved."

The Government is now busy trying to strengthen Internal Revenue's hand through new legislation designed to plug up tax law loopholes.

Under present tax laws, profits earned abroad by U.S. firms with foreign subsidiaries are subject to American taxation only when the earnings arrive here. This gives such companies a tremendous advantage over domestic corporations that get their profits solely in the United States.

The firms with subsidiaries, and we're talking about the honest ones, can continually postpone transfer of foreign profits and use the enormous tax saving to expand abroad.

OVERHAUL SYSTEM, PRESIDENT URGES

Tax deferral had for some time been favored by the Government as a means of encouraging American investment to restore the economies of wartorn nations, but now President Kennedy would like a complete overhaul of the system.

"Certainly," the President told Congress in a plea for tax reform, "since the postwar reconstruction of Europe and Japan has been completed, there are no longer, foreign policy reasons for providing tax incentives for foreign investments in the economically advanced countries."

Not long ago the Treasury Department drafted legislation to kill tax deferral altogether by taxing the earnings of subsidiaries yearly, with the exception of those in underdeveloped countries.

But the House Ways and Means Committee refused to go along with this. The committee did make it clear, however, that it was anxious to stamp out the abuses, such as sham subsidiaries, phony loan gimmicks, and improperly inflated pricing.

Treasury redrafted legislation with this express aim. Among other things, the new measures would hit the liquidation gimmick hard. But first those laws have to be passed.

It may take months for them to be enacted and even then there's no certainty that the laws will emerge in their original form. And even if they should, there's no guarantee that the smart operators won't ignore the new laws, or try to.

After all, the profits are beautiful and the tax experts who advise the chiselers are bright and imaginative.

NO. 3

You've just mailed your form 1040 to the Internal Revenue people and you're feeling great. You're entitled to a \$300 tax refund. Junior had his tonsils taken out, the wife had a cyst removed from her left hip and little Amelia has been getting shots to jazz up her blood. What with all the medical bills, and a few more items, Uncle Sam owes you money for a change. That 300 smackers should be just enough to get you a new set of golf clubs.

But you commit a fatal error. You tell the missus about the refund, and goodbye golf clubs. She says, with typical womanly logic, "Fine. Now we can get a new car."

So, with the refund and \$700 from your bank account, you and wifey go to your neighborhood auto dealer and wifey picks out a shiny new compact worth \$2,000. You tell the dealer you're putting \$1,000 down and financing the rest.

From that moment on, you, Joe Blow, ordinary citizen, become the hub of a web of intrigue, foreign and domestic, through which some very slick gents in the auto-financing business pocket millions of dollars that ordinarily would go in the form of taxes to the Internal Revenue Service.

JUST MORE GRIST FOR THE OLD MILL

You play no part in the intrigue.

The auto dealer tells you that the \$1,000 loan will be provided by a finance company, with appropriate carrying charges.

He adds that inasmuch as this is a loan, a credit insurance policy on your life will be

required. It goes, without saying, of course, that you pay the premium.

But you see nothing wrong with that. After all, if you drop dead before you've paid off the loan, why should the poor finance company be stuck?

Now here's what the dealer doesn't tell you. The finance company has an American insurance firm issue the policy. Since there are oodles of Joe Blows all over the United States buying cars on credit, the insurance company handles oodles of premiums.

If the firm were taxed by the United States on all those premiums, or earnings, the taxes would be immense. The U.S. corporate tax on earnings is 52 percent—more than half the profits.

Not that the American insurance firm would be exactly heartbroken. It still would be making lots of income.

But the finance company has other plans. At its bidding, the American insurance outfit keeps only 12 percent of the premium and then, as a bookie does when he's overloaded with bets on a certain horse, the company "lays off" the remaining 88 percent of your premium to an insurance company in Europe.

THEY LAY IT OFF IN TAX HAVENS

It's not just any old part of Europe. The European insurance firm is situated in a tax-haven country like Switzerland or Liechtenstein, where income taxes on corporation profits are either very small or non-existent.

So what happens to the profits? The lion's share is shifted to a no-tax country. The premium may seem small. But multiply it by thousands of Joe Blows getting insurance and it all becomes quite imposing. And it all escapes that nasty 52-percent tax.

At this point you may be impelled to ask why the men who run the finance company are so anxious to throw pretty American dollars to a firm in Europe.

It's quite simple, Joseph. That tax-haven insurance company in Europe is a foreign subsidiary owned by the American finance company.

By running an insurance company in a tax-haven country, those finance company foxes keep the bulk of the premiums out of reach of the Internal Revenue Service's hungry hooks. Now how does the finance company get those profits back?

Well, if the subsidiary sent the profits back as profits, the U.S. Internal Revenue crowd would promptly demand their 52-percent cut. So the subsidiary sends the profits back in the form of a "loan." Loans are not taxable.

As in the case of the shell or dummy subsidiary described in yesterday's article, the entire insurance transaction is performed on paper in the United States. Actually the premium money never leaves the United States and the loan never really takes place—except in the finance company's books.

ACTUALLY THERE IS VERY LITTLE RISK

You might say, wanting to be fair about it, those foreign insurance firms deserve a break—after all, they're shouldering the bulk of the risk, all those Joe Blows might drop dead any day.

The truth is that there is very little risk in this branch of insurance. Car loans usually are on a short-term basis, 1 year, 2, 3, and as a rule within those time periods. Joe Blow manages to stay alive.

So basically it isn't the risk that is laid off, it's the profits. And they're laid off in such a way that the United States doesn't get a piece of them.

At this point we would like to make it clear that not all auto-finance companies indulge in this foreign subsidiary dodge. Only some. But those that do are cleaning up.

We also want to add that there's nothing illegal about shifting the premiums to a tax-haven country. The only thing smelly about the deal is that loan back. But it's plenty smelly.

By the way, the insurance company in Europe could be a shell, with no staff whatever, or it could be an actual subsidiary. The point we want to make is that some bona fide subsidiaries and their parent companies also indulge in monkey business.

Here's another example. This one constitutes the most prevalent abuse in the foreign subsidiary setup.

Bigshot, Inc., a large American corporation, manufactures quite an assortment of articles, including, let's say, left-handed monkey wrenches.

THE LABOR IS CHEAP AND THE TAXES ARE NIL

So many southpaws in America are becoming mechanics that lefthanded monkey wrenches are selling like hotcakes. Bigshot's profits boom—but Uncle Samuel keeps grabbing 52 percent in corporate taxes.

If Bigshot could somehow divert a chunk of the profits to some tax-haven country, it would make much more money.

So Bigshot opens a subsidiary in a tax haven. A real factory, which we'll call Halfshot, Inc., goes into operation. Labor is cheap, but what's more important, there are virtually no income taxes on Halfshot's earnings.

In the fair competitive market, the wholesale price of a shipload of lefthanded wrenches is, let's say for the sake of simplicity, \$1 million. Halfshot sells its wrenches to Bigshot, but not at the regular market price of \$1 million per shipload. Instead, it charges Bigshot \$2 million.

Awful, isn't it? Here's a kiddie company soaking its papa company twice as much as it would charge a stranger.

It isn't a bit awful, when you get down to cases. Because when Bigshot pays Halfshot that \$2 million, the overcharge—\$1 million—represents profits actually made in America and therefore subject to the American corporate tax of 52 percent or \$520,000. Now that \$1 million, worth \$520,000 to Internal Revenue, eludes Internal Revenue and slips off to Halfshot, which is really Bigshot's baby.

Halfshot may do one of two things with the bonanza.

ONE GOT CAUGHT MOST OF THEM DON'T

It might invest it in still another operating subsidiary in Europe. This could go on and on until Bigshot runs a dozen subsidiaries—a hundred subsidiaries. The reinvested money is not subject to American taxation. What's more, Bigshot has become an international empire. With its built-up power and prestige, it will draw even more shareholders.

On the other hand, if Bigshot wanted the elusive profits back right away, it could simply arrange to have them sent back as a phony loan.

One company, with a subsidiary based in Latin America, used the inflated price gag with minor variations, but got caught and the U.S. Government clouted it with a \$4,500,000 tax bill. In most instances however, the boys don't get caught.

Some American corporations have the temerity to buy at inflated prices not from a genuine subsidiary but from a shell, a non-existent subsidiary.

Such corporations cotton to the loan gizmo. Firms operating with shells are generally "closely held"—that is, there are only a handful of shareholders and when the "loan" is made, each shareholder gets a big chunk of pie.

Yes, the shareholder has to pay personal income taxes on his cut, but the savings on corporate taxes make that cut much, much larger.

THEY KILL THE GOOSE BUT KEEP THE GOLD

Another nice tax gimmick, to which construction firms and movie companies are especially partial, is liquidation.

Way it works, an American movie firm sets up a subsidiary in a foreign tax haven to produce a single film overseas. After the subsidiary cleans up on the film, assuming it's a hit, the present company liquidates the sub—puts it out of business.

Had the film been made in Hollywood, the earnings would have been subject to that 52 percent tax. But when a foreign subsidiary's liquidated, the movie company has to pay Uncle Sam only a capital gains tax. This is 25 percent—or 27 percent less than the corporate profits tax. The tax-haven country, of course, charges little or nothing.

It used to be deemed foolish to kill the goose that lays the golden eggs, but in this instance, the goose doesn't start laying eggs until it's dead.

NO. 4

It isn't only the big, bad corporations that make money in foreign lands and keep the profits away from Uncle Samuel. Joe Blow does it too, as soon as he grabs a fat job abroad.

There must be something in that alien air. Or maybe it's the comfortable feeling a man gets knowing there's a couple of thousand miles of deep salt water between him and the Internal Revenue Service.

Americans living overseas enjoy tax breaks undreamed of by Americans at home. You'd think that would satisfy them, but it doesn't. In spite of all the wonderful exemptions they get, they are blithely pocketing an estimated \$200 million a year due our Government in Federal income taxes.

The individual American abroad isn't as cagey as the domestic corporation that sets up a foreign subsidiary as a tax dodge. What he owes the Government he owes purely out of ignorance. Just how much of this ignorance is real or feigned isn't known.

In an effort to pierce the dark veil of alleged dumbness, a gallant but paltry number of U.S. Government tax specialists—17 in all—are now fitting from foreign city to foreign city, setting up shop in American Embassies and consulates.

There are an estimated 575,000 American wage earners scattered throughout the world and it is the duty of the 17 to acquaint a large percentage of them with the harsh facts of tax life.

THE GLOBAL GANDER SEEMS TO PAY OFF

The round-the-world junket of the specialists, inaugurated in 1956, seems to be paying off.

In 1958, their program of education among the benighted "exiles" helped bring in 269,572 oversea returns and a total of \$152,680,000 in taxes. Last year there were 394,827 returns and a total tax take of \$272,441,000.

But Internal Revenue experts believe the current tax delinquency overseas is still close to 50 percent.

In one foreign district (a district may cover several countries); two hotshot Government specialists working less than 4 months picked up \$500,000 in delinquent taxes from persons who had not previously filed oversea returns, primarily because they didn't know they were supposed to file.

The specialists reported back that in the main the taxpayers they talked with were downright "eager" to file and pay.

A specialist who worked elsewhere found little of this unwanted eagerness in his bailiwick. "Some of them," he morosely reported back, "take off for the hills when they know we're in their country."

The guys and gals who hit for the highlands apparently were getting salaries well over \$20,000 a year and fell into what the

Internal Revenue people here call the "physical presence category."

These are Americans who live in a foreign country fairly long, but gad about. They are specifically required to be in a foreign country at least 510 full days during any consecutive 18 months. Also they can't work for the U.S. Government.

THE FIRST 20 GRAND IS EXEMPT FROM TAX

Americans in the "physical presence" category must pay taxes only on earned income exceeding \$20,000. The first 20 grand is exempt from tax.

An American earning \$20,000 a year, having a wife and two children, must kick in roughly \$4,000 in Federal income taxes if he lives in the United States.

If he enjoyed physical presence status overseas, he would keep the four grand. The \$4,000 is often a big selling point when an American company is trying to lure a bright technician or executive into working in a foreign subsidiary. The four grand amounts to a salary boost that in effect is subsidized by Uncle Sam.

But there's an even sweeter category than "physical presence."

To establish himself in this lovely classification, an American must have "bona fide residence" in a foreign country for one full tax year. He must set up permanent headquarters for himself and his family and settle down in the community.

If he fills the bill, he is completely exempt from paying any Federal tax on earned income.

The only income a bona fide resident may be taxed on is income derived from dividends, alimony, interest, capital gains, or a killing at Monte Carlo.

Government employees—and this goes for GI's—are completely excluded from the benefits enjoyed by non-Government residents overseas. The only exemptions they get are those that you, living here, get.

Why did American non-Government residents abroad become such a favored class?

The answer goes back to President Truman's point 4 program, which earmarked \$48 million to develop the world's backward areas. Something had to be thought up to attract American managers, technicians and skilled workmen to go overseas for 18 to 36 months. The something turned out to be the big tax break.

THE GIMMICK: LIFE IN TAX-HAVEN LAND

Now such dedicated technicians and workmen as Hollywood movie stars, producers and writers are cashing in on the break.

All they have to do is establish bona fide residence in a tax haven and every dime of their earnings—even if aforesaid earnings are \$1 million a year—goes untaxed by the United States. Dozens of movie people are doing it.

Ava Gardner restricted her income to U.S. tax-free earnings abroad and now some sources estimate her worth at more than \$5 million.

Actor William Holden has been another beneficiary of the oversea tax break and he doesn't mince words about it. He's said frankly he'd much rather work in Europe than pay the enormous tax exacted here.

Writer William Saroyan, currently escaping a big tax bite on earnings abroad, says he hopes to pile up enough cash through the exemption to pay off an old tax bill of \$20,000 confronting him on his return home.

Many others drawn by the Old World charm of Europe are leasing or buying homes or villas there, among them Yul Brynner, Jack Palance, Paulette Goddard, Audrey Hepburn, Van Johnson, George Sanders, Mel Ferrer, and Norman Krasna.

Bryner and company may not be wholly motivated by tax avoidance, but those who are may be in for an unpleasant setback.

KENNEDY SEEKS TO KO THE SETUP

President Kennedy, in a plea to Congress for tax reform, made it abundantly clear he didn't like a tax setup favoring citizens overseas. He said:

"I believe it is an unsound policy for the U.S. Government generally to subsidize through tax exemption those of its citizens who wish to live abroad. This is especially so for individuals who establish their residence abroad for tax purposes even though the nature of their business does not require it.

"It is manifestly unfair to other taxpayers to continue these exemptions which also contribute to our adverse balance-of-payments position."

The President called for complete elimination of the tax exemptions granted citizens living in economically developed countries and the Treasury Department drew up legislation in line with Kennedy's demands.

The House Ways and Means Committee deemed this a bit drastic. A compromise was worked out, which, though somewhat diluted, would hit such high-salaried foreign residents as movie stars pretty hard.

TECHNICAL EXPERT WILL STILL BE CLEAR

Under the proposed legislation, which is not expected to be put to a full vote for several months, the so-called bona fide resident loses his tax-free status. And he has to put in 3 years abroad to qualify for any exemption, at which time only the first \$20,000 of his earnings will be exempt from tax. Beginning with 4 years, the exempt amount rises to \$35,000.

This will still be a boon to many company executives and technical experts, but the benefits for film folks with astronomical earnings will be on the thin side. The bulk of their wages will be taxed precisely as earnings are taxed this side of the Atlantic.

No story about taxes and Americans abroad could be quite complete, we think, without the one about Charley Lehigh.

Charley, now 33, was an accountant employed in the Caracas, Venezuela, office of an American oil company. One day he went to a local racetrack called the Hippodrome. It was the first day at the track.

For \$2.40 he bought a pool ticket. He picked the first six winners of the day's card.

He won \$293,813. That's no misprint—\$293,813.

Next day, naturally, he was back at the track. This time he dropped \$2,000. He decided then and there he was through with horses.

Like the good American citizen he was, he filed an income tax return. But he contended that under exemption as an American abroad he could keep his horse winnings.

The Internal Revenue Service sharply disagreed. Ruling him deficient in the payment of his taxes, the IRS hit him with a tax bill which, including penalties and interest, totaled \$304,225.76.

HE FOUGHT SUIT FOR 6 LONG YEARS

But the Government made a couple of mistakes. First, it sent the deficiency notice by ordinary mail. Secondly it addressed the notice to "Apartado 53, Correos Este, Distrito Federal, Venezuela," a post office mailbox.

The letter from the IRS came back with the notation that it had been incorrectly addressed. The post office had more than 3,000 mail boxes and Charley's box was "Apartado 5375" and not "Apartado 53."

The Government sued Charley and Charley fought back, for 6 bitter years. The case moved up to the U.S. Western District Court of Arkansas, the State in which Charley now resides. Charley's sole defense was that he had not received the notice and therefore the tax assessment was nullified.

The court cited the tax laws which stipulate (a) that such notices must be sent out as registered or certified mail and (b) that it is the responsibility of the Government to make every effort to establish the correct address and send the notice to that address.

The court ruled that whichever party, tax collector or taxpayer, failed to comply with the tax laws, that party must take the consequences.

In this case, Internal Revenue took the consequences and Charley took the dough.

His hometown in Arkansas is appropriately named—El Dorado.

(Mr. DENT asked and was given permission to revise and extend his remarks.)

Mr. CURTIS of Missouri. Mr. Chairman, I yield 10 minutes to the gentleman from Texas [Mr. ALGER].

(Mr. ALGER asked and was given permission to revise and extend his remarks.)

Mr. ALGER. Mr. Chairman, I will attempt to add a few additional thoughts here today, if that is possible, but I want to clearly identify myself at the outset with my colleagues on the Republican side of the Committee on Ways and Means, particularly with the minority report. I would identify my views very closely with the views expressed in both the separate views and the views expressed by the gentleman from Missouri [Mr. CURTIS]. I will add to those views.

There have been several contradictions I would like to make now to statements made earlier, which I will not develop, but I merely want to mention because others have and will develop them further today and tomorrow.

This bill is not a balanced budget bill.

Our position on the Republican side is a very responsible position. Indeed, I would challenge the gentleman from Oklahoma who spoke earlier about irresponsibility that the irresponsibility lies clearly on the Democratic side on this bill. I think the rule suggested by the Republican side was a good one, and would not live to haunt us. It asked for action on a series of amendments. The gentleman from Louisiana said that this bill had the fullest consideration ever given to a bill in committee. Well, apparently I find that is not the case, because somebody did not give consideration properly, for example, to this question of foreign investment.

This matter of investment credit has been designated heretofore as a bonanza, and so that my colleagues can look at it in the morning before debate concludes, I shall extend my remarks as to the withholding feature and shall describe it.

Now, to go on to what I did want to speak of, I want to speak briefly on the foreign investment feature. We have the Trade Extension Act of 1962 before us at this time, and I was appalled to see that the Secretary of Commerce did not understand the implications of the tax bill before us when it is so closely tied to the trade bill before our committee, which will be before this House fairly soon.

I would like to quote Secretary Hodges' statement before the Eighth Annual Business International Washington Roundtable, when he said this:

To the extent that U.S. investment abroad increases the financial strength and the competitive capacity of American companies, it reinforces our domestic economy.

I would say "amen" to that, even though this bill would virtually destroy what Secretary Hodges himself said would be good for this country. Secondly he said:

And, to the extent that the earnings on these investments are returned to the United States, they make a direct contribution to improving our balance of payments.

I say on both counts the Secretary is right. What a pity he could not have so testified before the committee during the hearings earlier this year.

Now, I would like to refer to a statement made on page b-24 of the supplemental views. It is about as strong a statement as I have ever heard in a report:

The real purpose of this part of the bill is to prevent American business from operating in the world market—an astounding proposition in view of the Kennedy administration's trade program. When taken together, the administration would invite the foreign-owned producer to come in duty free while locking his American-owned competitor in the closet.

Now, my colleagues, while there are very few here, I want to point out to you that in the tax bill before us today and in the trade bill before the Committee on Ways and Means, which is holding hearings at this time, and the hearing will be going on, one thing clearly stands out. The Democratic Party seems determined to prevent U.S. industry from competing in the world market, and oddly enough, that is the conclusion so clearly borne out in both bills. Somebody is masterminding the destruction of private enterprise in the United States. Now, I have already quoted from page 24 of the supplemental views. Now, let me tell you what the tariff bill does and see how it relates to this. It gives the President of the United States the right to cut the tariff 50 percent in 5 years; it does away with the peril point, the escape clause, the Tariff Commission findings; takes away from the Congress all control, at a time when our tariffs are lower than the rest of the world, so that the rest of the world can flood this market with imports and we cannot compete abroad.

That brings me to this tax bill. What does this tax bill do? The tax bill says we are going to tax income before it is repatriated and put our American industry at a disadvantage as far as tax burdens are concerned, which the foreign nations do not have, making it impossible for our industry to compete. It has been said time and time again that foreign nations do not have the tax burden to carry that the U.S. industry does.

So, I ask you, put the tariff bill and the tax bill together, and what have you got? You have the destruction, as I see it, of the private enterprise system at a time when we are engaged in a life struggle with communism.

We are destroying the genius of the American people and making it impossible for our industry to compete.

Mr. Chairman, since time is running short, I ask permission at this point to include as a part of my statement the statement which I would have given, save for the debate I have heard today and the manner in which I have changed my remarks, because I am fearful that we are unaware even as Secretary Hodges was, that the tax bill and the trade bill are closely related. I would like to insert as a part of my views for those to read who are so minded, which I had prepared for tomorrow's debate my speech entitled "The Disastrous New Foreign Tax Features." I will be around tomorrow, as I know my colleagues will, to expand on these views.

I hope to possibly see this bill defeated or, rather, recommitted so we can strike out of the bill those parts which we know are dangerous. I certainly want to make it clear that I share with my colleagues on the majority side, as do the Republicans on this side, the view with reference to those sections of the bill that we think are worthwhile and necessary. We are heartily opposed to the three sections—investment credit, the foreign control investment tax, and the withholding provision.

Mr. Chairman, I shall withhold my remarks on those other sections which the gentleman from New York and the other Members on the Republican side will expand for you.

The novel and far-reaching foreign tax provisions of the Revenue Act of 1962—H.R. 10650—became known only after the bill first became public on or about Friday, March 16. Complex and intricate, yet comprehensive in scope, these provisions go far beyond any attempt to reach so-called tax haven income abroad or to close tax loopholes or to reach tax evaders.

No hearings have ever been held by any committee of the Congress on these proposals as now constituted. Consequently, only a handful of Members of the Congress and the interested public at large can possibly comprehend the revolutionary impact which these complicated measures will have.

In their application they will actually result, in a very few years, in a revenue loss rather than an offsetting gain. They will injure our balance of payments in the longer run, and reduce U.S. jobs. They will require more U.S. aid dollars to the less-developed countries, and they will conflict with our expanded export trade objectives. Here are some of the things these measures will do:

First. Tax at the foreign operating level, as if it were tax-haven income, the earnings derived from all expansions of U.S. industries in developed countries unless confined to the same trade or business carried on since December 31, 1962, or for a consecutive 5-year period—section 953(b), (3), page 120. This fore-shadows the demise of U.S. industry in the Common Market, for example, since it will permit normal expansion into new competitive product lines and evolutionary operations only on penalty of a U.S. tax burden borne by no European competitor. The U.S. oil company desiring

to develop new facilities in Europe will be deterred, and this will retard its oil production in the less-developed countries.

Second. Tax operating U.S. manufacturing firms overseas on foreign operating income deemed by the Treasury Department to be attributable to the use of American technology such as patents, copyrights, and processes—section 952(c), page 110. This fantastic and unworkable proposition would require the tracing of income from such historic inventions as Bell's transistor through endless transactions into countless products in the assembly chain of innumerable user companies. No foreign competitor would have to bear this added tax and administrative burden.

Third. Tax at the operating level, as if it were a "tax-haven," the operating income of centralized multicountry selling companies formed to market U.S. products made abroad—section 952(e), (2) page 112. Foreign competitors in the Common Market will suffer no such tax restraint, since their governments encourage marketwide selling and do not commonly tax even repatriated earnings from lucrative foreign opportunities.

Fourth. Class as so-called personal holding company income, and subject it to tax-haven treatment, a large variety of ordinary operating income of foreign subsidiaries of widely owned U.S. parent companies, such as interest on loans and installment sales, rentals of equipment, and dividends from local operating affiliates—section 952(e)(1), page 112. This would subject vast amounts of ordinary operating business income to a noncompetitive tax on the preposterous theory that it is "personal holding company income," a theory not applicable to the ever-present foreign competition.

These new taxes on foreign operating earnings of U.S. firms, newly pieced together bit by bit under the disguise of correcting tax abuses, would, in fact—

First. Reduce U.S. tax revenue. In most cases, the so-called tax-haven company is used solely to reduce foreign taxes. The less foreign tax paid, the more U.S. taxes will be collected when the funds are repatriated. Why? Because the foreign tax is deducted as a tax credit from the U.S. tax. Any provision increasing the foreign-tax burden of these companies automatically reduces the U.S. tax on account of the same income.

Second. Atrophy the present foreign market position of U.S. firms overseas, now to be more valuable to foreign interests free of these new burdens.

Third. Reduce U.S. exports, since Commerce figures show that a large percentage of our exports are instigated by our foreign subsidiaries.

Fourth. Reduce U.S. jobs, dependent upon these exports and the investment of remitted earnings to the United States.

Fifth. Injure our balance of payments through the inevitable dwindling of the present repatriation surplus, and through a tax-induced flight of U.S. private capital from the stock of U.S.

firms doing business abroad into portfolio investments in foreign companies not subject to these new taxes.

Sixth. Increase foreign aid, since Commerce figures show U.S. industry's profits in places like Europe flow to the less-developed countries. As noted, profits of U.S. oil companies' subsidiaries in Europe go in quantity into new investment in exploration and development in Latin America, Africa, and the Middle East where the oil is. The gross-up, also a part of this bill, will intensify this aid drain since U.S. firms will have to repatriate more from the less-developed low-tax nations to pay the U.S. tax on money they will have already paid in tax on the host governments there.

Seventh. Conflict with the objectives of the pending trade bill (H.R. 9900), since foreign trade and foreign investments are working partners, not conflicting antagonists.

Mr. Chairman, I would like to devote my remarks also to the "billion-dollar loophole" as the investment credit has been called. I cannot claim authorship for this description. It is taken from an editorial appearing in the Washington Daily News on February 14, 1962. I request permission to include this editorial in the RECORD at the conclusion of my remarks.

Why is the investment credit a billion-dollar loophole? Because we pay the taxpayer a subsidy for doing something that he was going to do anyway, and then give him a deduction on top of the subsidy. Here is how it works:

Let us take a manufacturing company that deducts from its taxes about \$1 million per year on account of depreciation. It annually invests about the same amount, or slightly more, for new equipment. That process will continue whether we pass this bill or not. Under this bill, however, that company will get a bonanza of \$70,000 without doing anything additional. What is worse, we do say to the company: "We will not charge you for this bonanza; you go ahead and write off the \$70,000 as a part of your depreciation just as if you had never received the credit."

Now, my example does not involve a very large company. It would not be in the first 500 in regards to size—it might not even be on a list of the first 1,000 companies; it might not even qualify for listing on the New York Stock Exchange. To this hypothetical company—and thousands more like it—the bill gives a handout which grows with the size of the company's investment.

Let us take another example: We read about the thoroughbred yearling sales—racehorses—in the State of Kentucky. Suppose a racing stable buys three yearlings for \$30,000. We will subsidize a part of the cost. In addition, the stable will pick up the full \$30,000 and write that amount off over the "racing life" of the horses. Under this bill, the Government will pay a subsidy for every yearling sold.

There are other innumerable instances where there can be no justification for

subsidizing the purchase of property by the taxpayer.

For example, the Government already subsidizes 50 percent of the cost of construction of U.S.-flag ships. The President's budget shows expenditures under this program for fiscal 1963 amounting to \$122 million. Yet, this bill provides an additional subsidy of 7 percent for each and every subsidized vessel built in the United States.

On the other hand, there is rank discrimination against the utilities. The bill provides for only three-sevenths of the subsidy per dollar of investment by the regulated utilities. And why? Because, we are told, the utility would be required to reduce its rates and thereby to pass on the tax saving to its customers. Therefore, the administration says, it would not accomplish anything. I ask you: Is passing on a saving to the customer wrong? I do not think so.

At the end of World War II, we had about 6,000 independent telephone companies in the United States. Almost half of these have since been swallowed up by the larger companies. This Congress purports to look with favor upon small business. These 3,000 independent telephone companies are small business, and much more deserving of a subsidy, if we are going to give one, than would be a lot of other businesses which will get this windfall.

This bill gives the independent telephone company less than one-half of the subsidy for the same dollar of investment which it gives to the racing stables, gambling casinos, and the like. Yet, the administration purports to be concerned over the domination of the communications industry by one or two large industries. It just does not make sense to me.

The withholding provisions of this bill will produce a boom for the computer people. If we pass this bill, we will be requiring the banks, insurance companies, and other paying agents, to install additional computers. In a vast majority of cases, these computers are rented rather than sold to the customer.

Under this bill, the companies, which are making and renting computers, will get a credit—an actual tax subsidy—equal to 7 percent of the value of every computer leased to a customer. You will be told that the bill permits them to pass this credit on to the customers. I doubt whether that is very realistic. They obviously cannot favor new customers over the old customers who rented computers before this "bonanza" took effect.

The investment subsidy is referred to by the proponents as being necessary to provide an incentive for American industry to modernize and expand in order to create more jobs. Yet, when the head of one of our largest labor unions—Walter Reuther—appeared before the committee in connection with the trade bill, he pointed out that our problem today was not lack of capacity to produce, but lack of customers to buy.

We all know very well that industry expands without any incentive if there is a market for its products and will not

expand where there is no market even if the Government does pay a part of the cost. The bill does not create any new market for our goods.

Most large corporations in American business have long-range programs for both replacement and expansion of facilities. These programs will be carried on regardless whether Congress approves this subsidy. The bill merely adds another burden to the individual American taxpayer for the financing of another Government subsidy program.

What will this subsidy really cost the American taxpayer? The true cost has been confused in the Treasury's statements by offsetting "stimulative effects" and psychological impacts which are supposed to minimize—actually to reduce by one-half the cost of this subsidy.

An impartial estimate was prepared by the staff of the Joint Committee on Internal Revenue Taxation—using the same assumptions which the Secretary of the Treasury adopted in a recent speech—but without taking into account any of these psychological factors.

Where will we get the money for this scandalous handout? This brings me to my second and major objection to this bill.

The principal major revenue-raising provision is withholding on interest and dividends—section 19. This is supposed to produce about \$600 million. When all of the other provisions of the bill are taken together, we still have a deficit—and this only because the majority is determined to give industry this subsidy which industry did not seek and, in general, has actually opposed.

At the outset, I would like to challenge those who claim that there is any analogy between withholding on interest and dividends and withholding on wages and salaries.

If we pass this bill, there will be more than 500 million savings accounts, insurance policies, shareholder accounts, cooperative patron accounts, Government bond redemptions, and the like, which will be subject to withholding. This is more than five times greater than the number of accounts subject to withholding on wages and salaries. Yet, 90 percent of personal income is paid in the form of wages and salaries, while only 10 percent is paid in the form of interest, dividends, and the like. About one-third of the more than 500 million accounts will involve withholding of \$1 or less.

In the case of withholding on wages and salaries, the employee claims his exemptions, and the withholding tables take into account his standard deductions. Yet, there is overwithholding in more than 40 million cases each year.

This bill provides for across-the-board withholding of 20 percent without taking into account the standard exemptions and deductions. It will cover all payments of interest, dividends, Federal bond redemptions, patronage dividends, interest and dividends on life insurance policies, and savings accounts, to mention only a few. It is an undisputed fact that an across-the-board rate of 20 percent for withholding will result in overwithholding.

How does the individual avoid this overwithholding? He cannot avoid it. For those 18 years of age and over, an exemption certificate may be filed only if the individual reasonably believes that he will owe no tax whatsoever from any source.

If an individual has wages on which taxes may be withheld, or will receive dividends and interest, which after all of his exemptions and deductions, will give rise to a tax liability of \$1, the individual cannot file an exemption certificate. The full amount of that individual's income from savings accounts, dividends, Government savings bonds redemptions, dividends or interest on life insurance policies, annuities, or any other similar transaction, will be subject to withholding.

No record will be made of this withholding. The individual will get no receipts for the amounts withheld. Obviously, it will be impossible for the Treasury to make any record of the exemption certificates which may be filed.

For those few who may wish to cheat, the withholding provision is no deterrent. In fact, under this provision they could obtain refunds of taxes which they did not pay. The Internal Revenue Service will have no records to show which accounts on which there has been withholding and which accounts were exempted.

By the Treasury's own admission, it cannot keep any records. No one will ever know how much of the revenue from withholding will represent taxes actually due and how much will consist of amounts collected in excess of any tax liability. We do know that the latter will be a substantial factor in any revenue yield from withholding. It is for that reason that I unequivocally state that the Service is not ready for any system of withholding at this time.

A glaring inequity lies in the treatment of tax-exempt institutions. A token exemption procedure is provided for those individuals who owe no tax; namely, those who are not taxpayers in its broadest sense. The same exemption is not extended to churches, charitable foundations, pension trusts, and other organizations which are tax exempt. Such organizations can only exempt themselves from interest on bank accounts. Their dividends will be subject to withholding irrespective of their exempt status.

I realize that these tax-exempt organizations can file quarterly claims for refunds. While they are awaiting the processing of that claim, other funds will be withheld from them. In the withholding-refund cycle, the Government will always be ahead. Therefore, the bill permanently deprives these organizations of a part of their funds—and for no valid reason.

The tax-exempt organization cannot be avoiding taxes, because it owes none. If an exemption procedure is practical for individuals, it is certainly that much more practical to extend the same privilege to tax-exempt organizations.

For the reasons I have stated, I recommend to the House that it consider care-

fully its vote on these two provisions from the tax bill:

The investment credit should be stricken from the bill because it is an outrageous subsidy and cannot be justified in the face of an ever-increasing Federal deficit; and

The withholding provision should be stricken from the bill because the Internal Revenue Service is not ready for it. It will result in taxpayer confusion and administrative chaos.

And, I might add, that when the Internal Revenue Service does complete its installation of automatic processing equipment to handle all of these returns, withholding will be unnecessary. A 20-percent withholding rate not only will produce massive overwithholding, but in those other cases where the effective tax exceeds 20 percent, provides no assurance that the full tax will be collected. The automatic matching of information returns with taxpayer returns will result in the collection of any taxes which may be due.

[From the Washington Daily News, Feb. 14, 1962]

BILLION-DOLLAR LOOPHOLE

The proposed investment tax credit might almost be termed the handout nobody wants. Yet it is urged by the President and conceded an excellent chance of approval by Congress.

Labor union leaders condemn it as a windfall for industry and industrial leaders are hardly more favorably inclined.

Emerson P. Schmidt, economic consultant for the U.S. Chamber of Commerce, told the Joint Economic Committee of Congress:

"A mere tax credit for investment is a loophole in the sense of not being available to all; it is a subsidy which general taxpayers should resent."

George G. Hagedorn, director of research for the National Manufacturers Association, told the same committee:

"It is difficult to see how giving \$1.5 billion with one hand, and taking the same amount away with the other, could increase the flow of savings available for investment. The chief result of the proposed investment credit would be to distort the patterns of capital formation, rather than to increase them in amount."

Under the plan, industries adding to their equipment would get an 8 percent tax credit. Thus if they spent a million dollars they could deduct \$80,000 from their taxes.

As encouragement to the whole of industry this is pure gimmick. It is unfair to high-employment service industries with relatively small invested capital. It is unfair to companies which have built their plant and prefer to emphasize sales promotion with their money.

If the Government is able to give back to industry some of its own money, it should consider a cut in present sky-high taxes on business income, which inflate retail prices and discourage risk taking in new ventures.

Even more urgent is the modernization of depreciation tables for tax purposes. These should recognize that much modern machinery has a far shorter useful life than equipment in the last generation when these tables were written. Recent revision of these tables for the hard-pressed textile industry has been highly constructive. Other branches of industry should be given similar treatment promptly. American depreciation allowances are the least generous in the whole industrialized world.

Unsound provisions in our tax regulations are a basic hindrance to employment and economic progress. The remedy lies in removal of these obstacles rather than in new

loopholes, still further cluttering up the tax system.

Congress has gone pretty far toward approval of this misguided plan but there still is time to substitute sound legislation.

Mr. KING of California. Mr. Chairman, I yield 15 minutes to the gentleman from Kentucky [Mr. WATTS].

Mr. VANIK. Mr. Chairman, will the gentleman yield?

Mr. WATTS. I yield to the gentleman from Ohio.

(Mr. VANIK asked and was given permission to revise and extend his remarks.)

Mr. VANIK. Mr. Chairman, in order to conserve the time of the committee, I want to take this opportunity to set forth a series of questions which relate to the investment credit and withholding sections of the bill. It is my hope that the distinguished chairman or some other member of the Committee on Ways and Means will respond to these questions during the course of general debate tomorrow.

First. If the tax credit principle is adopted, would it not serve as an impetus to higher investment spending in periods of higher profits in order to conserve tax liability, and correspondingly slow down investment in periods of recession and low profits when there will be less tax liability toward which to apply the credit?

In other words, will the tax credit serve as an accelerator toward boom or toward recession rather than as an economic stabilizer or constant stimulant?

Second. When the Treasury first submitted the tax credit proposal last year, it was established as an incentive for investment in excess of normal new investment. As modified, the investment credit is made to apply on the first dollar of investment including such new investment as the taxpayer would undertake in the normal course of events. Would this not serve to provide a taxpayer with a bonus for doing something he would do anyway?

Third. Should a taxpayer be rewarded for such new investment annually required in the normal course of his business?

Fourth. On page 459 of the committee hearings, Dr. Heller is reported to have said: "Other countries have benefited from systematically investing a bigger share of their gross national product in plant expansion and modernization. With less of their total income going into military and foreign-aid expenditures, they have been able to spend more on automation and other forms of industrial improvement without squeezing their output of consumer goods."

Did the hearings before your committee indicate that this country was lagging behind in defense plant expansion and modernization?

Fifth. As a matter of fact, does not the lag in growth in this country result from disproportionate growth in military production?

Sixth. Will the tax credit prove most beneficial and serve as a tax windfall to the defense contract producers who are already the recipients of Government aid in the form of defense contracts,

many of which are noncompetitive? Since military contracts are already a great prize—highly sought for—why should defense contractors be included in this bonanza?

Seventh. Insofar as the tax credit provides a credit against taxable income over and above regular depreciation, does not it constitute a return or recovery of capital to the taxpayer in excess of his original investment? If he collects depreciation plus 7 percent, does not the investor eventually get 107 percent on his investment or 114 percent if he is in the top tax bracket?

Eighth. Will an American taxpayer, for example, a utility, serving Washington, be entitled to a tax credit for the procurement of an electric turbine generator made in Switzerland provided it is acquired for use in the United States?

Ninth. Just how will that application of the tax credit create jobs in the United States?

Tenth. In the testimony before the committee, the Secretary of the Treasury indicated that his office was undertaking a revision of schedule F to synchronize it into the tax credit provisions. Am I correct in understanding that an updating of schedule F could cost the Treasury as much as another \$1 billion annually?

Eleventh. Will the tax credit be applicable at the normal rate or the utility rate to (a) corporations engaged in international communications; (b) interstate gas or oil pipelines; (c) production of electric power for interstate consumption; and (d) natural gas extraction?

Twelfth. The staff of the Joint Committee on Internal Revenue has estimated that the revenue loss attributable to the investment credit under the bill before committee amendments would total \$10,365 million for the period 1962-66 and approximately \$26,635 million for the 10-year period 1962-72. Will you kindly advise the estimated treasury loss in the same periods with the committee amendment?

Thirteenth. If the dividend withholding provision are adopted, will they not serve to compel corporations to issue stock dividends instead of cash dividends, thereby reducing annual tax collections of cash dividends taxable as ordinary income?

Fourteenth. Will the increased use of stock dividends taxable at the lesser rate as capital gains substantially offset anticipated treasury gains in dividend withholding?

Fifteenth. Has the Treasury provided any estimate of tax loss resulting from the shift of corporate profit distribution from cash dividends to stock dividends?

Sixteenth. If the withholding principle is enacted into law, would it not have the effect of driving investors into the tax-exempt issues where they would not be subject to withholding or to deposit in foreign banks or in foreign branches of American banks?

Seventeenth. Will foreign branches of American banks be compelled to withhold from savings accounts of American investors?

Eighteenth. Would the dividend withholding provisions relieve a taxpayer from any further obligation to report and pay on dividend income in his quarterly returns of estimated income?

Nineteenth. Under the withholding sections, withholding corporations are given express authority to use the Government's money for its own purpose for a period up to 30 days after the tax quarter period.

Does this grant of authority destroy the traditional trust relationship relating to tax funds which are the property of the United States?

Twentieth. Am I correct in understanding that the legislation actually invites the withholding institution to use these funds as part compensation for the additional expense of withholding?

Twenty-first. What recourse would the Government have against a withholding agent who permanently used withheld funds and fled into bankruptcy or receivership or simply absconded?

Twenty-second. Is there truth to the current report of the Bureau of National Affairs to business executives that the Treasury is working on further changes in the Internal Revenue Code to reduce the present 91-percent individual tax rate to 70 percent along with a cut of 2 or 3 percent in the lower tax brackets as well as the elimination of deductions for mortgage interest and property taxes?

Mr. WATTS. Mr. Chairman, I, too, would like to compliment the excellent work not only of our chairman but of the Members on both sides of the aisle for the many months that we have considered this tax bill.

Mr. Chairman, I urge rapid passage of the balanced tax bill so painstakingly constructed by the Ways and Means Committee. Its major provision—the investment credit—is essential to the economic health of our Nation.

Our ability to defend ourselves—to lead the free world—to create more jobs—to assure adequate business profits—to provide better highways, better schools, better housing—all of these urgent national needs are directly dependent on our capacity to accelerate our economic growth.

The tax bill now before us will increase that capacity by providing a tax credit for new investment by American industry in machinery and equipment.

This strong incentive to increase capital goods expenditures in this country by increasing the profitability or rate of return on such investment is the most effective and economical way of increasing our national growth.

The importance of increasing capital investment has recently been brought home to us with startling clarity by the experience of other major industrialized nations which have been outpacing us in overall economic growth. This growth has in almost every single case been accompanied by a level of capital investment correspondingly higher than our own.

New investment will create more jobs, as new technological developments, new processes, and new products are incorporated into our economic blood-

stream through use of more productive equipment.

A rising level of investment will help sustain the pace and duration of the present economic recovery throughout this year and thereafter. It will reduce our vulnerability to an early slowdown in the present economic expansion, and avert any early return to a pattern of economic decline and recession.

New investment will stimulate more efficient production through employment of more modern equipment—and more efficient production is essential to maintenance of price stability.

New investment is the key to expanding our commercial trade surplus, for only if American industry is as modern and efficient as any in the world will we be able to sell at competitive prices both in world export markets and against imports in our markets here at home. A larger trade surplus is crucially important if we are to wipe out the deficit in our international balance of payments. With increasing imports it is becoming constantly more important that we step up our competitive resistance at home and our ability to sell abroad.

Other nations now give investment in machinery and equipment more favorable tax treatment than American industry receives at home—thus encouraging American capital to move abroad. The investment credit provision of the pending bill will lessen this inducement to foreign investment and spur increased investment in our own productive capacity.

Mr. Chairman, the administration tax measure before us is a balanced bill. It provides a maximum stimulus to our economic growth at a minimum cost in terms of tax revenues lost. Some substitute proposals for the administration's investment tax credit would provide relatively little stimulus to growth in relation to their heavy cost in lost tax revenues.

A 40-percent first-year depreciation writeoff would, for example, cost more than four times as much as the investment credit—\$5.3 billion compared to \$1.2 billion. And it would require just that level of first-year writeoffs—a whole 40 percent—to increase the profitability of a typical 15-year asset as much as the investment credit would.

There has been proposed a 20-percent increase in all depreciation allowances. While the cost of both proposals would be roughly the same over a 10-year period, the investment credit would provide several times as much actual incentive to new investment—in terms of increased profitability—as would the alternative suggestion.

Get more credit by 7 percent now, whereas the 20 percent depreciation is spread over a number of years.

The relative merits of the two proposals are most clearly seen when it is realized that about an 80-percent increase in annual depreciation writeoffs—rather than a mere 20 percent—would be required to achieve a rise in the profitability of investment equal to that attainable by the 7-percent investment credit. And such an 80-percent increase would involve a cost over the next 5 years about twice that of the investment credit.

I would also like to emphasize that, contrary to the assertions of some, the investment credit gives the same dollar benefit to all taxpayers, whether large or small. The very fact that it is a direct credit against tax instead of a deduction makes it the same for all taxpayers, regardless of tax brackets. A corporation paying tax at the 52-percent rate or at the 30-percent rate or any individual, whether in a high or a low bracket, will obtain the same tax reduction in dollars for the same amount of investment. Accelerated depreciation deductions, on the other hand, do favor the more prosperous corporation.

Moreover, the investment credit provision contains several features specifically designed to be of aid to our small businesses. Among these are the allowance of the credit for up to \$50,000 per year on purchases of used property, and the allowance of the credit to the lessees of property in certain cases. Credit goes initially to lessor and he can treat the lessee as if he had bought it. Many of our small businesses cannot afford expensive new machinery and equipment, and it is their practice to modernize by replacing old, wornout equipment with more modern used equipment. The bill recognizes this problem and permits a credit for used property within limits commensurate to the needs of small businesses.

It is also a growing practice for some of our small businesses—which find it difficult to make the large outlays required for purchasing equipment—to lease it instead. By permitting the investment credit to be granted to lessees, the bill insures that small businesses will be able to gain the benefits of the credit.

One of the most significant benefits of the investment credit is its effects in materially shortening the payout period, which the businessman takes into account in weighing the feasibility of an investment. This payout period represents the time required for an investment to be recouped by the taxpayer. For a 15-year asset, a 7-percent credit—combined with double-declining balance depreciation—permits 27 percent of the cost of an asset to be recovered tax free in the first year, 39 percent in 2 years, and 65 percent in 5 years. The credit is especially effective in speeding investment cost recovery since it operates in the first year when funds are most needed and does not reduce depreciation deductions thereafter.

One of the major objections to the investment credit has been that it will give a tax benefit to companies which might have undertaken an expansion program without any additional tax incentive. This is, of course, true of any incentive, but it is incontestable that the best way to increase overall investment is to increase the incentive to invest. While the marginal investment produced by the incentive credit will never be precisely measurable, there is no doubt that a 7-percent credit against taxes will play a major role in influencing business decisions.

The investment credit is essential to increasing our export trade, so that we can earn the foreign exchange we need to wipe out our balance-of-payments

deficits—deficits which have cost us almost \$6 billion in gold in the last 4 years.

Substantially increased investment is necessary if we are to attain the degree of competitive effectiveness and productivity which can enable the Nation to balance its international payments without withdrawing its national security forces from overseas bases and abandoning the less developed countries of the free world to economic, political and military penetration of the Communist bloc.

The investment credit, by increasing efficiency, will make our producers more competitive both in foreign and domestic markets, will be of significant help to the U.S. trade position—and this is particularly important in the light of the coming trade legislation.

As for the implications for our national growth, I cannot do better than to quote the detailed discussion of this subject contained in a recent speech by Henry H. Fowler, Under Secretary of the Treasury. He gave the following factual analysis:

Fifty percent of our present productive capacity was installed before or during World War II. More than 65 percent was installed before the Korean war. Thus, of all business plant and equipment, less than one-third is modern in the sense of being new since 1950.

Estimates show that there has been a startling rise in recent years in the proportion of our national machinery and equipment which is over 10 years old. It now averages more than 9 years, and from 1954 to 1959 the stock of equipment over 10 years old rose by 50 percent. In a dynamic economy that average should be falling as new equipment is put into place.

Meanwhile, other countries have been lowering the average age of their fixed capital. The German example is the most spectacular—their proportion of capital equipment and plant under 5 years of age grew from one-sixth of the total in 1948 to two-fifths in 1957.

Mr. Fowler went on to discuss the leveling-off in business expenditures on plant and equipment. Such investment for 1961 was more than 3 percent below 1960, and more than 6½ percent below 1957. While an increase is expected in 1962, the proportion of gross national product devoted to such investment will still be substantially below 1957 and 1958. The 1962 investment is expected to be about 6.5 percent of gross national product, compared to 8.3 and 8.4 percent in 1957 and 1958. Commenting on this lagging investment Mr. Fowler continued:

This pattern is even more disturbing when measured against the performance of investment levels in productive machinery and equipment in other industrialized societies.

Our gross fixed capital expenditures (other than housing) have declined from 12.5 percent of gross national product in 1948 to 9.5 percent in 1960. By comparison, the investment ratio in Western European countries rose from an average of 13.3 percent of gross national product in 1951–55 to 15.1 percent of gross national product in 1956–60.

Even greater percentages of gross national product are said to be devoted to new machinery and equipment in Japan. This means our manufacturers must compete against their friendly rivals in the free world to get a larger share of export markets and to keep imports from getting a larger share of our domestic markets, with our machin-

ery and equipment being replaced at a much slower rate than theirs.

Mr. Chairman, the investment credit is needed today to help keep the current recovery moving forward. In the last 12 months we have witnessed a substantial economic advance. But by late 1962 our continued advance will depend heavily on the ability of fixed investment outlays as a key expansionary force.

Increasing investment levels in machinery and equipment will help make our present economic recovery a vigorous and longer lasting one. The completion of plans and the authorization of additional private expenditures on machinery and equipment and the plants and facilities necessary to house them will create more jobs in the capital goods industry and more demand for a wide variety of products and services. This is the sector of the economy which has been lagging behind for the last 4 years. There is a strong association between full employment, vigorous and long upswings in the economic cycle, and the healthy increase in the levels of capital goods expenditures. The projection of a substantial increase in investment levels for machinery and equipment, whether for modernization or expansion, would be added assurance that the current recovery would achieve full employment and promise to be more enduring than the last one. The early enactment of the investment credit, as contained in H.R. 10650, would provide a strong incentive for this increased investment.

In summary, the investment credit provision of the legislation before us is important because this country has not been producing at full capacity for some years. Our Nation's reserves—the talent and skills of our people and the quality of our raw materials and physical plant—are impressive, but they are not presently being fully utilized and our level of unemployment is uncomfortably high.

We simply must grow faster, for economic strength is essential to our survival as a free and prospering nation. Certainly growth alone, or larger investment by itself, is no guarantee that we can solve all of our pressing problems. But accelerated growth—to which new investment can make such a vital contribution—will provide the economic underpinnings of our country's future strength.

An expanding economy will enable us to meet the challenges that confront us in the international area, and will furnish additional revenues that will enable us to provide better for the public and private needs of all of our people. The investment credit will greatly increase the ability of American business to make a maximum contribution to the achievement of these goals.

I call upon every Member of this House to join in passing the pending tax bill and without delay, for the stimulating effect of the investment credit is urgently required if our economy is to operate at full speed. This bill is an investment in America's future. It therefore merits the affirmative vote of the distinguished Members of this House on both sides of the aisle.

Mr. CURTIS of Missouri. Mr. Chairman, I yield 10 minutes to the gentleman from New York [Mr. DEROUNIAN].

Mr. DEROUNIAN. Mr. Chairman, before discussing the withholding provisions of this bill I must comment on the remarks made by the gentleman from Massachusetts [Mr. O'NEILL] when the rule was being debated. I recall that he stated in castigating the minority side for seeking a modified closed rule: "Why do not the Republicans bring in a rule where we could reduce oil depletion?" I think that is a very good question and I will give you a very good answer: We are only 10 on a committee of 25. I say that I do not think the chairman of our committee would dare bring that rule up to reduce the percentage oil depletion because it would be embarrassing to his majority leader, the gentleman from Oklahoma [Mr. ALBERT], who comes from an oil-producing State. He would be embarrassing his majority whip, the gentleman from Louisiana [Mr. BOGGS], who comes from an oil-producing State. He would be embarrassing a lot of subcommittee chairmen on his side who come from oil-producing States. I would make this categorical statement that a bill to reduce oil depletion allowances does not have a chance while the Democrats are in control of Congress.

Mr. LINDSAY. Mr. Chairman, will the gentleman yield?

Mr. DEROUNIAN. I yield to the gentleman from New York.

Mr. LINDSAY. That sounds like a big, great national issue.

Mr. DEROUNIAN. The majority leader of this House would not vote to reduce oil depletion, and the Democrats know it.

Let us get to the import of this bill.

Mr. Chairman, I wish to go on record as being unalterably opposed to the withholding tax on dividends and interest embodied in H.R. 10650. It is nothing more than a fraudulent scheme to destroy the exemptions which this Congress has written into our revenue laws for the young, for the old, for the thrifty, and for the small investor. It is a classic example of the meat-ax approach, and if we pass this bill we will be back here next year only because the people will not yet know what we have done to them. Undoubtedly with this in mind the administration asks that the withholding not be made operative until after January 1, 1963—after the November elections.

I would call this bill the IBM tax bill. By withholding, we make it essential for most businesses to rent a computer. By the investment credit, we give the computer companies a windfall or tax subsidy on every computer that they rent. For most of them, this will be the equivalent of a special tax rate on all of their new business. No one has estimated how much this cost the Treasury, because no one can foresee the magnitude to which this bill will stimulate the demand for computers. As the caption of a recent article in the Wall Street Journal, on February 8, 1962, read "Withholding Tax on Interest Promises Computer Boom and Depositor Confusion."

We have all heard the glib statement that "since there is withholding on salaries and wages, there should also be withholding on dividends and interest." Those who have studied the matter should know better than to advance such a specious argument.

In the case of withholding on salaries and wages, there is only one employer-employee relationship at any one time during the taxable year. The employee is permitted to claim any exemptions to which he might be entitled. The rate of withholding is supposed to take into account his normal deductions. Every effort has been made to be certain that there is no "overwithholding." Yet, the Treasury processes 40 million refunds each year on account of overwithholding. Instead of adding to this, we should be taking steps to minimize overwithholding on wages and salaries.

The new bill provides for a flat rate of 20 percent for withholding. The statistics show that for a large number of taxpayers, the rate of withholding is excessive. Furthermore—and this is particularly significant—the Treasury does not propose to keep any record of this withholding in order that it might refund to the individual money which has been unjustly withheld. The taxpayer gets no information return, and the Treasury keeps no records of withholding.

You will be told that the bill avoids any hardship because it provides for an exemption certificate for any taxpayer who will not owe any tax. You may not be told how this certificate will work. How effective will it be?

Except for those under 18 years of age, no one can file an exemption certificate who will file a return showing \$1 of tax liability. In other words, to file an exemption certificate, you cannot be a taxpayer. If any part of your income is taxable, regardless of whether the tax on that income is paid by withholding, declaration of estimated tax, or otherwise, you cannot file an exemption certificate. It is an all-or-nothing proposition. Who can take this gamble and run the risk of incurring the penalty if they guessed wrong?

Of course, the fine is only \$500 or imprisonment for not more than 1 year or both for filing a false certificate, but each individual will have to file an exemption certificate each year for each shareholder account, each transaction with a cooperative, each bond coupon cashed in, each savings bond redeemed, and each savings account on which interest may be credited. Multiply the \$500 fine by the number of accounts, and you get a better idea of what the penalties might be in the case of a taxpayer who guessed wrong.

How many accounts will there be subject to withholding? Does anyone have any idea? In a recent speech, the Commissioner of Internal Revenue stated that there were 350 million payments of \$10 or over just on accounts of dividends, saving account interest, and Federal and corporate bonds which would be subject to withholding. If we add to that number all of the accounts on which the payment would be less than \$10, the

dividends from cooperatives, interest credit on life insurance policies, and the other transactions which will be subject to this withholding provision, we get an astronomical figure. Five hundred million would be way too low. My guess is that it will exceed 1 billion transactions, but no one has any way of knowing. In a majority of the cases, the amounts involved will be nominal so that withholding will be nothing more than a nuisance tax.

What does this mean? There are more than 52 million savings accounts in our commercial banks and more than 29 million savings accounts in the savings and loan associations. In the case of commercial banks alone, there are about 32 million savings accounts on which the amount withheld will be less than \$1. There are more than 50 million accounts overall on which the amount withheld will be less than \$10.

The number of shareowners having a stake in American industry has more than doubled. More than 15 million Americans own shares in our major corporations. More than 3 million of these are shareowners with low incomes, for whom relief from double taxation of their dividend income makes the investment of their savings in American industry worth the risk. The bill would nullify that exemption as to these small shareholders. With respect to the first \$50 of dividend income, the bill would levy a withholding tax of 20 percent even though the law says that the income is exempt. In the case of withholding \$10 or less, the shareholder is required to wait until the end of the year and swear out a claim for refund to get his money back.

If the Treasury believed for a minute that these millions of small savers were going to file claims to get back withholdings of \$1 or less, the administration-sponsored measure would result in a loss of revenue because of the administrative costs. Obviously, the Treasury is counting on the fact that very few depositors will go to the trouble and expense of swearing out a claim for refund to cover less than \$1, particularly, since most of these taxpayers will not even have a record of the amounts which have been withheld. There is no requirement for either the Treasury or the withholder to furnish the depositor with such a record.

We are adopting a scheme whereby the Government of the United States proposed to supplement its income by the simple expedient of collecting a small amount, not otherwise due, from millions of individuals who can reasonably be expected either to forget or to neglect to prosecute claims for the refund of their money. Many of our elder citizens will die without getting their money back. I doubt if such a proposal could get past the Better Business Bureau if it were not the Government itself.

The Treasury has the means at its disposal to collect any taxes on this money which might rightfully be due. The system of assigning numbers to taxpayers, and installing automatic data-processing centers for handling taxpayers' returns, could readily be extended

to cover the matching of information returns with the individual returns. The Treasury is already using a "meat ax" on the paying agent in order to obtain such information returns.

I would like to include as part of my statement an announcement in the Washington Post of February 27, 1962, under the masthead "IRS Warns of Fines if Deadline Not Met," and the news release issued by the Internal Revenue Service, to which the newspaper refers:

[From the Washington Post,
Feb. 27, 1962]

IRS WARNS OF FINES IF DEADLINE NOT MET

The Internal Revenue Service warned businessmen yesterday they will face fines of \$1 if they willfully fail to report by Wednesday a 1961 payment to customers, stockholders and others.

Corporations, banks, insurance companies and other firms must file information returns covering all dividend payments of \$10 or more and all payments of \$600 or more in interest, fees, commissions, pensions, annuities, rents and royalties.

The announcement said penalties would be imposed for willful failure to file the returns. A spokesman, asked to specify the penalties, said a fine of \$1 may be imposed for each offense.

IRS said the filing of information returns is becoming more important because of its shift to computer processing of income tax returns. The computers will automatically check data on information returns against the income reported by individual taxpayers.

[From Internal Revenue Service
news release, Feb. 26, 1962]

Internal Revenue Commissioner Mortimer M. Caplin today reminded persons engaged in trades and businesses they are required to file by Wednesday, February 28, information returns on forms 1099 and 1096 reflecting payments of \$600 or more to those with whom they did business in 1961.

The Commissioner pointed out that with the advent of the automatic data processing system, the Service will be making maximum use of these forms in checking whether the recipients of the income are reporting it on their Federal tax returns.

He said the Service therefore will check closely to see that banks, savings and loan companies, credit unions, insurance companies, and other business entities are meeting the requirement of filing information returns. These are necessary on payments of interest, rents, royalties, annuities, pensions, fees, commissions, etc., aggregating \$600 or more.

The Service will also check to see that such forms are filed reflecting payments of dividends of \$10 or more, as required by law.

Unlike Federal tax returns, the information returns are not filed with District Directors of Internal Revenue. They are required to be filed with Internal Revenue Service centers, the addresses of which are listed in the instructions for such forms. The internal revenue laws provide penalties for willful failure to file these returns on or before the due date.

Forms 1099 and 1096, and the instructions, can be obtained from any Internal Revenue office.

In the same speech to which I referred previously, the Commissioner objected to the use of his new computer system for collecting any taxes which may be overlooked on dividends and interest because he stated that the cost of matching information returns would run about \$5.5 million a year. This certainly is not an unreasonable expense

if we can avoid at double the cost imposing the burdens of this withholding provision on individuals, churches, charitable organizations, and the like. It would be cheap at twice the price. However, the Commissioner then complains that a mere determination of the tax due would not produce the revenue—that the taxpayers would not pay their tax even if the Treasury billed them. I do not accept that statement.

All we have to do is look at the volume of consumer credit on which our economy is predicated if we have any doubt of the inherent capacity and integrity of the American citizen to pay his bills. All our commercial transactions are based upon the extension of credit to the consumer. However, the administration would have us believe that he cannot be trusted. This is indeed astounding.

If we pass this bill—with the withholding provision in it—we will be giving our approval to this administration's claim that the millions of recipients of dividends and interest are deadbeats, bill skippers, and cannot be trusted. I, for one, am unwilling to do this because I do not believe it.

Mr. Chairman, in order to illustrate that confusion was rampant on this session of the bill, this provision was changed four times before the bill was finally drafted as it came before the House today.

Mr. Chairman, speaking of the bill, reference was made to the expense accounts by another speaker. May I say this: One day in the committee we had what we called "Silly Day" because we passed this provision that if a businessman or taxpayer had proved he had spent \$100 on entertainment, and if it were legitimate and provable, he could claim only 50 percent of it. In other words, the taxpayer proved himself 100-percent innocent but they found him 50-percent guilty. Even the Democrats who voted for this provision against the protest of the Republicans had to run from the Restaurant Union, the Bar Tenders Union, and then 16 doctors from the city of New York issued a release that this was an unreasonable provision, a provision which their own party had backed. Then we changed it, and rightfully so. So all of this bill has not been carefully thought out. There has been pressure in many cases. For that reason unless a motion to recommit by the majority side is approved, I am certainly not going to vote for the bill, and one of the main reasons will be this withholding provision.

Mr. KING of California. Mr. Chairman, I yield 10 minutes to the gentleman from Missouri [Mr. KARSTEN].

(Mr. KARSTEN asked and was given permission to revise and extend his remarks.)

Mr. KARSTEN. Mr. Chairman, I am going to support this bill.

Mr. Chairman, the Revenue Act of 1962 is one of the most important measures upon which we shall vote during this session of Congress. Its impact upon our economy may be greater than any other single piece of legislation that has come before the Congress in recent years.

In its strict sense, it is a revenue bill but in its application it is much more than that. It represents an effort on the part of the administration and the Congress to encourage the modernization of American productive facilities to make them more competitive in expanding world trade and to stimulate our own economic growth. To accomplish these broad objectives we must first substantially increase the rate of capital equipment investment in order that our industries can provide themselves with modern tools and equipment. I know that American industry can successfully compete with any nation in the world if we will but make the effort to do so.

This bill is the instrument by which we can expand the economy of the United States, improve our competitive position, and open up new export outlets abroad.

Our economy is growing but it must grow at a faster rate during the decade ahead if it is to expand sufficiently to attain a gross national product of some \$800 billion, and to provide 13 million new jobs by 1970. A large part of the gross national product will depend upon the ability of American industry to make its products competitive with products of other nations, both at home and abroad. Equally important will be the labor force of 85 million workers. In short, we must outproduce and outsell our competitors if we are to gain any economic ground in the next decade.

To accelerate business investment, the bill generally provides, in section 2, an allowance against income tax of 7 percent of the cost of new depreciable property, excluding real estate. This means principally machinery and plant equipment.

Testimony presented to the committee shows that if full advantage is taken of the investment credit provisions over the next year it will represent a plant modernization program approximating \$40 billion. By 1970 we may expect a program aggregating almost \$60 billion which will mean higher income, fuller employment and greater use of American industrial capacity.

The plant modernization program is really an investment in the future of America.

Tax programs as a business incentive have been in use by foreign countries for many years. This has resulted in many American companies locating new plants abroad, where they have been able to secure the benefit of so-called foreign tax havens.

If our domestic plant modernization program is to be successful we must also eliminate these foreign tax-haven incentives, which are resulting in the exportation of American industry and American jobs. Section 13 of the bill makes substantial progress in discouraging such practices by closing the tax loopholes on income earned abroad.

These two sections, section 2 to encourage the modernization of our domestic productive capacity, and section 13 to discourage the exportation of American industry abroad, constitute the major premise of the Revenue Act of 1962.

Furthermore, even though the allowance of the 7-percent investment incentive tax credit will result in a revenue loss of an estimated \$1.175 billion in a full year of operation, the revenue-raising provisions which are contained in the other sections of the bill will more than offset this loss. In fact, the Treasury Department has estimated that the overall revenue effect of this bill will result in a net revenue gain of \$120 million to the Government in a full year of operation. In addition, the revenue-raising provisions of this bill will provide greater overall equity in our income tax system through the elimination of a number of loopholes and special tax preferences that are presently contained in our tax laws.

In addition to the elimination of the foreign tax haven incentives referred to previously, the bill would make a number of changes in the tax treatment of foreign income which are designed to insure that such income bears its fair share of the current tax burden.

Another revenue-raising provision would impose stricter limitations on allowance of income tax deductions for business entertainment and related expenditures by requiring a more proximate and direct relationship between such expenditures and the active conduct of a trade or a business than is required under present law. This provision is designed to deal with the widely publicized and flagrant abuses that have developed under present law in the business entertainment expense area. It would also overrule the so-called Cohan rule of present law, under which courts have permitted a deduction for estimated amounts of business entertainment expenses in situations in which there was insufficient evidence to establish the actual amounts of such expenses. Under the bill, no deduction would be allowable for unsubstantiated business entertainment expenses.

The bill would also subject mutual insurance companies to a revised tax formula which would take into account the underwriting income realized by such companies. Under present law, mutual insurance companies are taxed only on their investment income, whereas competing stock insurance companies are taxed on both their underwriting and investment income. Under the bill, more equitable tax treatment is provided for these competing forms of business organizations.

Another revenue-raising provision would close a loophole that exists under present law which effectively permits the conversion of ordinary income to capital gains in circumstances in which property which has been subjected to depreciation is sold for a price in excess of its depreciated cost. Under the bill, any excess of the price for which such property is sold over its depreciated cost, which is attributable to depreciation deductions taken with respect to the property after December 31, 1961, will be treated as ordinary income rather than as capital gain.

In the area of the tax treatment of cooperatives, the bill would provide that

the profits realized by these organizations will be taxed currently, either to the cooperative or to its member-patrons. This treatment is in accord with the intent of Congress in enacting legislation on this subject in 1951, but which intent was thwarted by certain court decisions. This provision of the bill will also go far toward eliminating the competitive inequities that exist under present law between cooperatives and competing forms of business organizations.

The most important revenue-raising provision contained in the pending bill is the one that will institute a system of withholding a tax at source on interest and dividends. This withholding system is designed to insure the collection of some \$600 million of taxes on these income items which are presently due and owing to the Federal Government, but which, through negligence, inadvertence, or design, are not being reported by some taxpayers on their tax returns, and with respect to which tax is not being paid. It should be emphasized that this provision is in no sense a new or additional tax but is merely a method of collecting taxes that are imposed by present law. In order to minimize the inconvenience and hardship to taxpayers, however, exemption certificate procedures that are provided for those taxpayers who owe no current taxes and rapid, quarterly refund procedures are provided for taxpayers with respect to whom excess tax might be withheld.

These revenue-raising sections, as well as a number of other similar provisions contained in the bill, will provide greater equity in our income tax system and the revenue gains resulting therefrom will preclude the investment incentive credit from resulting in any overall revenue impact. I strongly urge my colleagues in the House to vote in favor of the pending bill.

Mr. CURTIS of Missouri. Mr. Chairman, I yield such time as she may require to the gentlewoman from New Jersey [Mrs. DWYER].

(Mrs. DWYER asked and was given permission to revise and extend her remarks.)

Mrs. DWYER. Mr. Chairman, the Revenue Act of 1962 as reported from the Committee on Ways and Means is, in my judgment, a bad bill and I intend to vote against it unless appropriate amendments are adopted or a motion to recommit the bill is successful.

It is a bad bill, I believe, because it is discriminatory, because it fails to cover a number of the most glaring loopholes in our tax laws, and because at a time when a balanced budget is essential this bill will almost certainly produce a significant budget deficit in fiscal year 1963.

It is important to emphasize, Mr. Chairman, that a vote against the pending bill would not be a matter of fiscal irresponsibility. On the contrary, it would be the most responsible possible vote. Members of Congress are sometimes accused of voting for expensive new Federal programs and then refusing to vote for the revenue measures necessary to pay for them. This is not the case with the pending legislation. The budget for fiscal 1963, as submitted by

the President, was proposed to be balanced, and without the new revenues specified in the present bill. The revenues now under consideration are earmarked, in effect, to pay for the investment tax credit which is included in the same bill. In other words, the defeat of the bill would not affect the budget one way or another.

Before dealing with the substance of the tax bill, there is another consideration I believe we should keep in mind. It is no secret that a great many Members on both sides of the aisle are seriously disturbed about the provisions of this bill, either in whole or in part. To save as many of these votes as possible, it is being suggested by some that the House ought to pass the bill and then let the Senate delete or amend the questionable provisions. This argument has all the earmarks of irresponsibility, and I for one cannot accept it. Certainly, we in the House should not have to depend on our colleagues in the Senate to correct our mistakes. Unless we are satisfied that this is the best bill that can be written, we should return it to the Ways and Means Committee with instructions to rewrite the bill accordingly.

The greatest inequity in the bill, Mr. Chairman, is the impact of the proposed withholding scheme for income from dividends and interest on the millions of Americans who have a savings account, a few shares of stock, or an insurance policy. Despite the efforts of the committee to provide for quarterly refunds where a person's tax liability is less than the amounts of income withheld, the proposed plan will still result in a great deal of overwithholding. And overwithholding, by its very definition, deprives the taxpayer of income that belongs to him, not to the Government. Moreover, the procedures required to administer this withholding plan are necessarily involved and will introduce into the lives of taxpayers, especially the smaller taxpayers, a new flood of complicated tax forms, exemption certificates, refund claims and the like.

For these reasons, it is apparent, I believe, that the heaviest burden of the withholding plan will fall on those persons least able to carry it. This is a complete reversal of the basis on which our revenue system rests. To deprive people who need every cent of their income, especially the older and retired members of our population, of any part of that income for periods of a month or more cannot be justified. It is likewise unjustifiable to subject people unnecessarily to increasingly complicated income tax returns, especially people who cannot afford the services of tax accountants or lawyers.

I share the concern of the administration and the committee at the substantial loss of revenues from interest and dividends due to the failure of many taxpayers to report such income. I cannot believe, however, that the only alternative to these losses is the proposed withholding system, as full of inequities and other objectionable features as it is. I strongly agree with the minority report on the bill that the administration should pursue measures already initiated in an

effort to increase the rate of compliance before resorting to the extreme solution of withholding. The use of information returns, for example, would be a simpler and much more convenient method of obtaining maximum compliance, especially since many people who do not report income from dividends and interest fail to do so only because of ignorance of the requirement.

The immediate purpose of the withholding provision is, of course, to raise sufficient new revenue to help pay the cost in lost revenues of the proposed new investment credit. There is an unfortunate irony involved in this arrangement. What it comes down to, apparently, is this: a highly inequitable revenue-raising procedure, particularly burdensome to those with lower incomes, is to be the means of providing a special tax windfall or bonanza to big business—a windfall which business in general has not asked for.

The purpose of the investment credit—to provide an incentive for economic growth and business expansion, an objective universally shared—can be achieved at far less cost to the taxpayers and without requiring costly tax windfalls by substituting for the tax credit a provision allowing for increased depreciation of the same kind of business assets. Instead of tax forgiveness or a new form of subsidy, this would be tax postponement. It would also, so far as I can determine, be a more effective and longer lasting form of incentive for business growth. And it would accomplish this without requiring the imposition of a withholding system, since its effect on the budget would be substantially more moderate than the investment credit.

There seems to be general agreement on all sides, Mr. Chairman, that we should use the tax system as a tool to achieve greater economic growth—together with all that economic growth means in terms of higher employment, a stronger competitive position in foreign trade, increased national security, and an improved balance-of-payments position, as well as greater overall prosperity for our people.

In seeking these objectives, however, we should use discrimination in the means we choose. We should make certain that in helping one part of the country we are not hurting another. We should avoid forcing one group of our people to pay for the prosperity of other groups. And we should take care not to open larger loopholes in our tax laws when we purport to shut existing ones.

In my judgment, Mr. Chairman, the pending bill fails on all these counts, and for that reason I must vote to recommit the bill or, failing that, I must vote against it on final passage.

Mr. CURTIS of Missouri. Mr. Chairman, I yield 3 minutes to the gentleman from New York [Mr. DOOLEY].

Mr. DOOLEY. Mr. Chairman, I strongly oppose this legislation.

We have heard many good arguments, fortified by statistics, against H.R. 10650, the Revenue Act of 1962. Most of these presentations have been in the form of

possible national effects that would result with enactment of this bill.

I would like to read into the RECORD, however, the remarks of a president of a savings bank located in my district. I think they will add greatly to the current discussion. The writer of the statement, Mr. Danby C. Osborn, is not only one of my constituency's leading citizens but also one who has devoted his life to building a savings institution which has lent strength and vitality to the community which it serves.

Mr. Osborn's letter reads as follows:

THE HOME SAVINGS BANK,
White Plains, N.Y., March 27, 1962.

Hon. EDWIN B. DOOLEY,
Congress of the United States,
House of Representatives,
Washington, D.C.

DEAR CONGRESSMAN DOOLEY: In reply to your letter of February 6, and as you suggested in that letter, I am taking the liberty of outlining for you in short form the effects that passage of the new tax bill would have on the Home Savings Bank here in White Plains, if passed.

First, my desk is out on the bank floor and I have many opportunities to greet and talk with the customers of the bank. I detect a very strong resentment on the part of many customers as to possible withholding. One result of the passage of the withholding provision would, we think, temporarily cause some withdrawals on the basis of psychological reaction, even though there would be no point in people doing so. As far as the bank itself is concerned, this represents a massive clerical job making the banking operation more cumbersome and less efficient, in addition to more expensive. The end result will be that the customer will suffer in some way, although the degree cannot be measured. It is true that if the withholding provision is passed, it will affect all financial institutions equally, therefore there is no disadvantage competitively.

Second, as to the revised schedule in the bill to increase the Federal tax on mutual savings banks and savings and loan associations, a short form summary will work out as follows: The deduction of 3 percent of net new real estate loans to be allowed as a free bad debt reserve would not give us the equivalent deduction available under the alternate of taking 60 percent of net taxable income.

Our net taxable income for the	
year 1962 is projected at-----	\$500,000
Less 60 percent-----	300,000

Net subject to tax-----	200,000
Approximate tax-----	100,000

It can readily be determined that the effect of this tax proposal will deprive the bank of approximately 20 percent of its net retention for reserves. The bank would therefore be 20 percent less effective in its ability to set aside reserves in relation to deposit growth. Instead of being able to support deposit growth of \$6 million adequately, the figure would be reduced to approximately \$4,800,000. Growth would have to be arbitrarily controlled within these figures as a savings bank cannot continuously take on new growth without setting aside adequate reserves for the protection of depositors. The result would be at the very least about \$1,250,000 less going into the mortgage market each year. This figure probably would be somewhat larger as it would be natural for the bank to seek tax exempt securities up to a certain point, therefore making still less available for the mortgage market.

The effect of this bill in our opinion is directly contrary to the objectives of the administration which seeks economic growth in the country to keep up with the population

growth. Any country which puts the damper on thrift incentive and the progress which it produces, is performing a great disservice to the public.

Very sincerely yours,

DANBY C. OSBORN,
President.

Mr. MILLS. Mr. Chairman, I move that the Committee do now rise.

The motion was agreed to.

Accordingly the Committee rose, and the Speaker having resumed the chair, Mr. ROOSEVELT, Chairman of the Committee of the Whole House on the State of the Union, reported that that Committee, having had under consideration the bill (H.R. 10650) to amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes, had come to no resolution thereon.

SEVENTY-FIFTH ANNIVERSARY OF THE INTERSTATE COMMERCE COMMISSION

Mr. FORRESTER. Mr. Speaker, I ask unanimous consent for the immediate consideration of the joint resolution (H.J. Res. 441) to commemorate the 75th anniversary of the Interstate Commerce Commission.

The Clerk read the title of the joint resolution.

The SPEAKER. Is there objection to the request of the gentleman from Georgia?

There was no objection.

The Clerk read the resolution, as follows:

Whereas April 5, 1952, is the seventy-fifth anniversary of the Interstate Commerce Commission; and

Whereas the Interstate Commerce Commission is the oldest regulatory agency in the United States, having been established by the Act to regulate commerce enacted on February 4, 1887; and

Whereas the duties and responsibilities of the Interstate Commerce Commission have been expanded throughout the past seventy-five years so that its activities in regulating the transportation industry now affect the life of every citizen of the United States: Therefore be it

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the President of the United States is authorized and requested to issue a proclamation designating the 5th day of April 1962 as Interstate Commerce Commission Day, for the purpose of commemorating the seventy-fifth anniversary of the Interstate Commerce Commission.

The joint resolution was ordered to be engrossed and read a third time, was read the third time and passed, and a motion to reconsider was laid on the table.

HOURLY MEETING TOMORROW

Mr. ALBERT. Mr. Speaker, I ask unanimous consent that when the House adjourns today it adjourn to meet at 11 o'clock tomorrow.

The SPEAKER. Is there objection to the request of the gentleman from Oklahoma?

There was no objection.

PERSONAL ANNOUNCEMENT

(Mr. CLEM MILLER asked and was given permission to extend his remarks at this point in the RECORD.)

Mr. CLEM MILLER. Mr. Speaker, during the last few days there has been a flurry of statements, speeches, and press releases concerning a book called "The Liberal Papers."

It has been alleged that this book or these papers were sponsored, proposed, supported, produced, or published by certain Members of this body—apparently because these Members of Congress are further alleged to be or to have been members of the liberal project.

Since the matter has been raised on the floor of the House, it now seems proper for me to comment here.

A Republican National Committee press release dated March 20, 1962, stated that the liberal project is or was sponsored by 35 Democrats, all present or former Members of the House of Representatives. This same press release also included the following correction:

Press reports used as source material for Republican National Committee comment on "The Liberal Papers" erroneously named Representative GEORGE P. MILLER, Democrat, California, as one of the sponsors. It is now understood that Representative CLEM MILLER, Democrat, California, was the person whom the press dispatches meant to name.

We deeply regret any injustice done to Representative GEORGE P. MILLER.

Insofar as any press release or any press report meant to name me, it was done without my knowledge or authority. If I had been informed it would have been repudiated.

I am not and never was a member of any liberal project. I do not and never did sponsor, propose, or support the book, "The Liberal Papers," or these papers separately, or the views expressed by their authors. I have had nothing to do with producing or publishing the book or the papers.

Although I have not read the book or the papers, I personally disagree with and do not and never did endorse the views or proposals which they express, as they have been reported by the press and as stated in the various press releases on this subject.

THE DEAD SEA SCROLLS

(Mr. MATTHEWS asked and was given permission to extend his remarks at this point and include a talk by Mr. LIBONATI.)

Mr. MATTHEWS. Mr. Speaker, each Thursday morning a number of us meet for an hour's discussion of religion and for spiritual fellowship to help us meet the problems of the day. At one of our meetings several weeks ago, our able colleague, Hon. ROLAND V. LIBONATI, Representative from Illinois, gave a splendid talk on the discovery of ancient Hebrew manuscripts known as the Dead Sea Scrolls in a cave in the desert of Judea. This talk was so well received by our group that I know it will be of interest to all earnest students of religion. I am, therefore, happy to enclose a copy of this scholarly and inspiring address by

Digest of CONGRESSIONAL PROCEEDINGS

OF INTEREST TO THE DEPARTMENT OF AGRICULTURE

OFFICE OF
BUDGET AND FINANCE

(For information only;
should not be quoted
or cited)

Issued March 30, 1962
For actions of March 29, 1962
87th-2d, No. 49

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HIGHLIGHTS: House subcommittee voted to report REA and FHA section of farm bill. House passed tax bill. House committee reported Youth Conservation Corps bill. Senate passed Treasury-Post Office-Executive Office appropriation bill. Both Houses received President's reorganization plan on science and technology functions.

SENATE

1. **TREASURY-POST OFFICE-EXECUTIVE OFFICE APPROPRIATION BILL, 1962.** Passed as reported this bill, H. R. 10526. Conferees were appointed. (pp. 5023-33) This bill includes appropriations for the Bureau of the Budget, Council of Economic Advisers, and Advisory Commission on Intergovernmental Relations.
2. **SCIENCE; RESEARCH.** Both Houses received the President's Reorganization Plan No. 2 providing for certain reorganizations in the field of science and technology (H. Doc. 372) (pp. 5021-2, 5003-4). The Plan provides for the establishment of an Office of Science and Technology within the Executive Office of the President, the appointment of a director of the Office by the President with the advice and consent of the Senate, and the transfer to the Director of certain functions of the National Science Foundation.
3. **TARIFFS.** The Finance Committee voted to report (but did not actually report) without amendment H. R. 10607, to amend the Tariff Act of 1930 so as to provide

for the adoption and implementation of revised tariff schedules proposed by the Tariff Commission and to make certain amendments in existing law necessitated by the adoption of such revised schedules. p. D224

4. PUBLIC LANDS. The Public Lands Subcommittee of the Interior and Insular Affairs Committee approved for full committee consideration S. 1485, to authorize the Secretary of the Interior to sell certain unsurveyed public lands along the Snake River in Idaho. p. D224
5. DAIRY INDUSTRY. Sen. Morse inserted a letter and resolution from the Malheur County (Ore.) Farm Bureau opposing the dairy provisions of the proposed farm bill. pp. 5051-2
6. APPROPRIATIONS. Received from this Department a report of an overobligation on an allotment. p. 5022
7. FORESTRY. Received from this Department a proposed bill to add certain land-utilization project lands to the Pike National Forest in Colorado and the Carr National Forest and the Santa Fe National Forest in New Mexico; to Agriculture and Forestry Committee. p. 5022
8. SALINE WATER. Received from Interior a report on the saline water program for 1961. p. 5022
9. NOMINATIONS. Confirmed the nominations of Jennings B. Fuller and William T. Steele to be members of the Federal Farm Credit Board, FCA. p. 5023
10. SOIL CONSERVATION. Agreed to without amendment S. Con. Res. 62, commemorating the 25th anniversary of the establishment of soil conservation districts. p. 5039
11. FEDERAL EXPENDITURES. Sen. Wiley spoke in favor of his proposal to provide for "the creation of a permanent Hoover-type Commission to keep a watchful eye on Federal spending." pp. 5050-1
12. PERSONNEL. Passed over, at the request of Sen. Carlson, S. 919, to amend the Hatch Political Activities Act so as to eliminate the requirement that the Civil Service Commission impose no penalty less than 90 days suspension for certain violations. p. 5038
13. EDUCATION. Sen. Morse inserted the transcript of his TV debate with Sen. Tower "What Should Be the Role of the Federal Government in Education?" pp. 5052-4
14. ADJOURNED until Mon., Apr. 2. p. 5054

HOUSE

15. FARM PROGRAM. The "Daily Digest" states that the Subcommittee on Conservation and Credit of the Agriculture Committee 'ordered' reported favorably to the full committee title V (amended) (REA and Farmers Home Administration) of H. R. 10010, the general farm bill." p. D226
16. TAXATION. By a vote of 219 to 196, passed with amendments H. R. 10650, the proposed Revenue Act of 1962, including revisions in tax provisions relative to cooperatives (see Digest 38 for items of interest). pp. 4941-97



United States
of America

Congressional Record

PROCEEDINGS AND DEBATES OF THE 87th CONGRESS, SECOND SESSION

Vol. 108

WASHINGTON, THURSDAY, MARCH 29, 1962

No. 49

House of Representatives

The House met at 11 o'clock a.m.

The Chaplain, Rev. Bernard Braskamp, D.D., offered the following prayer:

Matthew 9: 36: *When He saw the multitudes, He was moved with compassion on them.*

Most merciful and gracious God, we humbly acknowledge that we are living in days when multitudes are baffled and bewildered, feeling that something within the heart of humanity has gone terribly and tragically wrong.

Inspire the God fearing everywhere to declare plainly by character and conduct that their faith in Thee is active and alert although too great for their groping minds to fully explain and express in formula and creed.

Grant that we may possess a victorious faith which fulfills itself in faithfulness and is manifested in an unswerving loyalty to that which is noble and true.

Give us a greater concern and compassion for all mankind and may we never forsake the weary and lonely who have fallen under some heavy burden which we might have lifted.

Hear us in His name who looked upon the multitude with compassion. Amen.

THE JOURNAL

The Journal of the proceedings of yesterday was read and approved.

MESSAGE FROM THE PRESIDENT

A message in writing from the President of the United States was communicated to the House by Mr. Ratchford, one of his secretaries, who also informed the House that on the following dates the President approved and signed bills of the House of the following titles:

On March 13, 1962:

H.R. 10050. An act to provide for a further temporary increase in the public debt limit set forth in the Second Liberty Bond Act.

On March 16, 1962:

H.R. 7855. An act granting the consent of Congress to an amendment to a compact ratified by the States of Louisiana and Texas and relating to the waters of the Sabine River.

On March 20, 1962:

H.R. 2990. An act to confer jurisdiction upon the Court of Claims to determine the claim against the United States of Amis Construction Co. and San Ore Construction Co.;

H.R. 3879. An act to authorize and direct

the Secretary of Agriculture to convey to the State of Wyoming for agricultural purposes certain real property in Sweetwater County, Wyo.;

H.R. 7666. An act to amend section 17(a) of the Revised Organic Act of the Virgin Islands pertaining to the salary of the government comptroller; and

H.R. 8723. An act to amend the Welfare and Pension Plans Disclosure Act with respect to the method of enforcement and to provide certain additional sanctions, and for other purposes.

On March 22, 1962:

H.R. 5143. An act to amend section 801 of the act entitled "An act to establish a code of law for the District of Columbia," approved March 3, 1901.

MESSAGE FROM THE SENATE

A message from the Senate by Mr. McGown, one of its clerks, announced that the Senate had passed a joint resolution of the following title, in which the concurrence of the House is requested:

S.J. Res. 171. Joint resolution providing for the establishing of the former dwelling house of Alexander Hamilton as a national memorial.

COMMITTEE ON APPROPRIATIONS

Mr. THOMAS. Mr. Speaker, I ask unanimous consent that the Committee on Appropriations may have until midnight Friday to file a report on the second supplemental appropriation bill for 1962.

The SPEAKER. Is there objection to the request of the gentleman from Texas?

There was no objection.

Mr. BOW reserved all points of order against the bill.

HON. DAVID J. ARNOLD

Mr. FLYNT. Mr. Speaker, early this morning I received the sad news of the death of an outstanding Georgian and a warm personal friend of mine, the Honorable David J. Arnold, of Griffin, Ga.

Mr. Arnold was a prominent businessman, banker, a former chairman of the Fourth District Democratic Executive Committee, and a former member of

both houses of the General Assembly of Georgia.

Mr. Speaker, I ask unanimous consent to include in the Appendix of the RECORD today further remarks pertaining to Mr. Arnold.

[The matter referred to appears in the Appendix of today's RECORD.]

CALL OF THE HOUSE

Mr. GROSS. Mr. Speaker, I make the point of order that a quorum is not present.

The SPEAKER. Evidently a quorum is not present.

Mr. ALBERT. Mr. Speaker, I move a call of the House.

A call of the House was ordered.

The Clerk called the roll, and the following Members failed to answer to their names:

[Roll No. 49]

Anderson, Ill.	Dingell	Shelley
Andrews	Fascell	Sheppard
Ashley	Hoffman, Mich.	Short
Bates	Norrell	Smith, Miss.
Bennett, Mich.	Nygaard	Spence
Blatnik	O'Hara, Mich.	Steed
Blitch	Powell	Stubblefield
Brooks	Rains	Teague, Tex.
Celler	Reuss	Tollefson
Clark	Roberts, Ala.	Tupper
Colmer	Scherer	Vinson
Dawson	Scott	Walter
Dent	Selden	Wilson, Ind.

The SPEAKER. On this rollcall 395 Members have answered to their names, a quorum.

By unanimous consent, further proceedings under the call were dispensed with.

MINORITY VIEWS

Mr. McCULLOCH. Mr. Speaker, I ask unanimous consent that the minority members of the Select Committee on Small Business be permitted to file minority views to accompany House Report No. 1471 and that such views be printed as part II of such report.

The SPEAKER. Is there objection to the request of the gentleman from Ohio?

There was no objection.

REVENUE ACT OF 1962

Mr. MILLS. Mr. Speaker, I move that the House resolve itself into the

Committee of the Whole House on the State of the Union for the further consideration of the bill (H.R. 10650) to amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes.

The motion was agreed to.

Accordingly the House resolved itself into the Committee of the Whole House on the State of the Union for the further consideration of the bill H.R. 10650, with Mr. ROOSEVELT in the chair.

The Clerk read the title of the bill.

The CHAIRMAN. When the Committee rose on yesterday the gentleman from Arkansas [Mr. MILLS] had 2 hours and 11 minutes remaining; the gentleman from Illinois [Mr. MASON] had 2 hours and 15 minutes remaining.

Mr. MILLS. Mr. Chairman, I yield 1 minute to the gentleman from Louisiana [Mr. HÉBERT] and ask unanimous consent that he may proceed out of order.

The CHAIRMAN. Is there objection to the request of the gentleman from Arkansas?

There was no objection.

Mr. HÉBERT. Mr. Chairman, as will be recalled, on last Wednesday this Committee considered a bill which authorized proceeding with the so-called RS-70 which was recommended by the Committee on Armed Services under the direction of its distinguished chairman, the gentleman from Georgia [Mr. VINSON]. He and the Armed Services Committee received a vote of confidence in this House by a vote of 403 to 0 to proceed with the RS-70.

This action of the chairman of the Committee on Armed Services of the House was based on an interchange of letters from President Kennedy and Secretary of Defense McNamara assuring the committee a new study would be made of the proposed program of the RS-70.

Subsequent to that action there appeared in the press of the Nation a statement from a so-called high spokesman of the Department of Defense who said, in effect, that the exchange of letters meant nothing; that nothing new was promised, and that the same program would continue in effect. This statement caused considerable confusion and misunderstanding.

I think it important to bring to the attention of the House at this time, in view of that vote and in view of the conflicting statement, a statement released at 10:30 this morning by Mr. McNamara, Secretary of Defense. This is a most important statement, and I ask your indulgence to pay very close attention to it.

I now read the complete text of the statement issued a few hours ago by Secretary of Defense McNamara:

I am disturbed by reports that the study of the proposed RS-70 weapons system which I pledged in my letter of March 20 to Chairman VINSON, is being handled in a routine fashion.

The Air Force is carrying out the study at my request. It prepared the instructions for the study on March 20 and issued them on March 21. The study is being carried out by an Air Force military-civilian team under

the direction of the Under Secretary, Dr. Joseph Charyk. Maj. Gen. David Burchinal, Director of Plans, has been assigned the responsibility for studying the operational uses of the system. Gen. Bernard Schriever, commander of the Air Force Systems Command, will be responsible for preparing detailed analyses of alternative development plans, including plans for the integration of reconnaissance strike components into the aircraft, for flight test of the completed systems, and for possible flights of test aircraft beyond the three presently authorized. Working with General Schriever and General Burchinal on the state of technical development of the important components of the system, including the sideview radar, data processing and display systems, is the Assistant Secretary of the Air Force for Research and Development, Dr. Brockway McMillan. Dr. McMillan will be assisted by a team of experts from Wright Field.

More than 10 different contractors are scheduled to assist the Air Force in the restudy of the program over the next several weeks.

Members of the Committee, I submit this answers in full the position of the Department of Defense and of Mr. McNamara, whom I congratulate on this statement, which fortifies the position of the House and that of Chairman VINSON and the Committee on Armed Services in the procedure which was adopted.

There are many who have misinterpreted and distorted exactly what the situation was following the conference between President Kennedy, Secretary McNamara, and Mr. Vinson. It has been baldly misrepresented by some reporters and commentators that Mr. VINSON and the Committee on Armed Services had capitulated because it, in its wisdom, had substituted the word "authorize" for "direct." The statement made by the so-called high spokesman in the Office of Defense gave strength to this inaccurate presentation. It was a gratuitous slap not only at Mr. VINSON and the Committee on Armed Services but at the entire House of Representatives which had voted 403-0 to support Mr. VINSON and his committee.

Surely a rose by any other name is still a rose and smells just as sweet. Just as positive are the real and true facts surrounding the now famous stroll in the White House rose garden by President Kennedy and Mr. VINSON. No matter how distorted and misrepresented the facts have been they are still the facts and Secretary McNamara, by his statement, has substantiated these facts as presented to this body last Wednesday. Facts are facts even distorted by misrepresentation.

And if I may be permitted to paraphrase some remarks of Mr. VINSON to the Committee on Armed Services: "The only smell is the sweet fragrance of the rose garden and Secretary McNamara's statement takes care of that."

Mr. VINSON has not capitulated, the Committee on Armed Services has not capitulated, the House of Representatives has not capitulated, and Secretary McNamara boldly and firmly stands behind his agreement to take a new look at the RS-70 program and if found feasible to proceed with its production as authorized.

I hope this sets and keeps the record straight.

Mr. MILLS. Mr. Chairman, I yield 15 minutes to the gentleman from Louisiana [Mr. BOGGS].

Mr. BOGGS. Mr. Chairman, the Committee on yesterday consumed about half of the time allocated for general debate, and at about 4 o'clock this afternoon we will cast, in my opinion, two of the most important votes that we will be called upon to cast in the 87th Congress, if not in the postwar history of the United States of America.

The vote will come, first, as I understand, on a motion to recommit to be offered by a distinguished member of the minority of the Committee on Ways and Means, and in the time allotted to me I will seek to analyze, as best I can, the proposals which have been brought to our attention that will be in the motion to recommit.

We have been informed that that motion will include two items: No. 1, a straight striking of the investment credit without any substitution therefor; and No. 2, a straight striking of the withholding provisions without any substitution therefor. There may or there may not be other provisions in the motion to recommit, but I am informed—and I may be presuming because the minority at any time may change its mind—that these will be the elements in the motion.

Mr. Chairman, let us try to analyze what is involved here. There has been discussion in the business community as to whether or not we should substitute for the tax incentive, for the investment credit, what is called a fast writeoff, fast depreciation. Some segments of the business community have said that they would prefer that approach.

There has been some discussion in the business community in which some businessmen have expressed a preference for so-called fast writeoff, or fast depreciation. As far as I know there has been no element in the business community which has taken the position that they need nothing.

Mr. Chairman, here in the year of our Lord 1962, with a growing competitive free enterprise, modernized industrial plants in the Common Market countries of Europe and in Japan in the Far East, I know of no one in the business community who does not maintain that we need stimulation for new investment in the United States of America at this time.

Mr. Chairman, the motion to recommit does not substitute anything for the provisions which we in the committee have submitted for consideration to this House. The committee looked at great length to the suggestions about a fast writeoff. The committee came to the conclusion that under existing legislation, wherever a given industry could present a case in which they showed that, because of obsolescence related to automation or because of any number of other economic factors, a more rapid depreciation rate was justified, then under existing law the Treasury Department can prescribe regulations therefor right now without changing a sentence in the law as it stands.

Mr. WILLIS. Mr. Chairman, will the gentleman yield?

Mr. BOGGS. I will be glad to yield to the gentleman from Louisiana.

Mr. WILLIS. Do I understand that the investment credit which the gentleman is now talking about is not a substitute for the normal depreciation under our laws, but is in addition thereto?

Mr. BOGGS. The answer is "Yes"; most assuredly yes.

Mr. Chairman, to carry on the line of thought for just one moment, in the case of the great textile industry which has maintained, and I think with considerable justification, that it has been subjected to intense import competition, that industry is now operating all over our country, both in New England and in the Southeast, with new depreciation schedules which are on the books which reflect a realistic life. But more is needed.

But, I say, Mr. Chairman, that this recommittal which we will have says that business does not need anything more. Now, frankly, I must say that I confess some surprise about this approach coming from this side of the aisle.

Many of us on our side of the aisle have been confronted in political forums and the other areas of public expression with the charge that our party has been unfriendly to business, that we have not been sympathetic to the need for investment, that we do not understand the requirements of capital, that we do not know how much it takes to invest to provide for just one employee, that we are not aware of this great trend of foreign competition, that seeing American industry pricing itself out of the world market we are unwilling to do anything about it.

One would think after hearing these expressions, all of which are subject to rather careful scrutiny, that maybe our side of the aisle would be opposing the investment tax credit and this side of the aisle would have proposed it. As a matter of fact, it really is incomprehensible how the great Republican Party, which has declared repeatedly that it is the party of business and free enterprise, should be completely opposed to this proposal in the light of the modern conditions.

Let us look at some of the conditions confronting industry. Let us try to ascertain as best we can why industry needs some provision at this time.

First, our population is growing at a phenomenal rate. We read about the so-called population explosion in Asia and Africa and Latin America and elsewhere in the world, but believe me, there is a population explosion in the United States. The population of my State of Louisiana is 4 million or thereabouts, maybe a little more or a little less. In the course of 12 months we add to the United States of America a brandnew State the size of Louisiana in population, about 5 million in 12 months. This means that by graduation from high schools and colleges and training schools and other preparatory institutions it is incumbent upon our Congress to provide assurance that the economy will provide well over a million new jobs per annum for new people entering the labor market.

In addition to this, this challenge comes at a time when we see moving into the economy a force which very few of us understand, and that is a force called automation. All of you experience automation every day. I look around the Capitol here and I see we have automated elevators. I guess it is a good thing in order to give employment to these youngsters that we still keep them on these elevators, but they do not need to be on them. There is an elevator right over here that you can get on after 5 o'clock in the afternoon and there is no boy on it. All you do is press a button and go where you want to go. We keep the boys on to let them go to school and get an education, and so on. But in the office buildings in New York City, Detroit, New Orleans, San Francisco, Los Angeles, and Buffalo, there is nobody running elevators any more. That is just one example.

Years ago in my State, in the growth of sugarcane we used literally thousands and thousands of man-hours, and we used labor in the rawest sense of the word. Today it is estimated that 1 man-hour of labor in the Louisiana sugar fields is the equivalent of 4,000 man-hours of labor in southeast Asia producing the same thing.

In every form of industry we see the need for automation. Elsewhere in the world, there has been a faster pace of automation than in the United States. In the six countries now comprising the European Common Market the industrial plant percentage is probably 50 percent more modern than the American industrial plant.

Now what does that mean? That means that a plant built, let us say in 1958 producing a given manufactured article, is competing with a plant built in the United States in 1945 or 1950. It means that the plant built in Europe or the plant built in the Far East, let us say in Japan, is more modern and more automated, more productive, more competitive than the plant built in Detroit or Buffalo or Schenectady or New York.

What else does it mean? Well, it may mean that this plant is built to compete effectively in the American market, but it more probably means that it competes more efficiently and more effectively in the marketplace of another country such as Brazil, Argentina, or Peru, or some other country in the world.

Now what does that mean? Let us look at that for a moment. How does that affect it? You hear about the balance of payments. What is the balance of payments? What does a deficit in the balance of payments mean? How does that affect you and me? How does it affect your constituents? What does it do to business in Charleston, S.C., may I ask my good friend and colleague from that great State [Mr. RIVERS]. Well, let us analyze it for a moment. When you have a deficit in the balance of payments, you have an outflow of gold. Why do you have an outflow of gold? Because it is more profitable then for money to go elsewhere than it is for it to remain here in this country. What happens when that comes about? You see it happening all around you right

now. The interest rate in the mutual thrift institutions today is about 4½ percent. The interest rates in the savings banks are higher than they have been at any time since the 1920's. Interest rates generally are higher than they have been since that time.

What does that mean? That means that a school bond issue in Charleston, S.C., may cost twice as much as it would cost if the interest rate had been lower. That means that rather than build a particular facility which is desperately needed, again because of the population explosion, the local taxpayers may not be able to afford it. What does that mean? It means that instead of having new jobs for new construction and instead of buying new materials and buying materials and steel and automobiles for transport and instead of building houses for the workers to live in, these things do not happen. What does that mean? That means that you have a backup all the way down the line. What does that mean? Does it mean new employment? No, it means unemployment. What does that mean? That means more deficit financing. That means more problems of inflation. It means more problems as to the stable dollar.

What else does it mean in the world picture? Does it mean that we recapture the markets that we must have to correct the balance of payments? No, it means we continue to lose those markets. Now how do we bring about a balance in this balance of payments proposition? Let us look at the factors affecting the balance of payments which contribute to the imbalance. What are the minus factors that affect the outflow of American dollars? They are military establishments all over the world. There are foreign aid programs. There is tourism, people traveling all over the world. There are investments all over the world.

Now let us take the plus factors one at a time. What are the plusses of the balances of payments?

First. The return from investments abroad, in other words, a comeback of the dividends.

Second. Tourism, people traveling in the United States from elsewhere.

Third. Most important of all, American exports to other places in the world.

Now what do you do about that? Can we at this stage of our history call our troops back to our shores? Can we abandon the posts and bases that we have?

Can we abandon the Air Force base? Can we leave Germany with the Berlin crisis a continuing cancer for the whole free world? Dare we abandon our bases in the Far East with the Red Chinese Communists sitting there waiting to gobble up all of southeast Asia? Dare we do it? If we did, we could save 3 or 4 billions a year in the balance of payments. We cannot do it, I do not believe. So we cannot have much saving there.

We have effected quite a lot of savings in certain buying policies. We are now insisting that our troops buy more from American producers so that we do not

have a drain on dollars there. There are several other things we could do which become almost totalitarian. We could stop people from traveling abroad; we could say this to your constituents who want to go to Europe or to Asia or somewhere else: You cannot take more than \$100 with you. Other countries have had to do this. We do not do it, and let us hope we will never have to do it.

What are the plusses? The plusses are, No. 1, exports. Last year we had a surplus of exports over imports of about \$5 billion. The whole impact of the tax incentive program is to give our industry a competitive position wherein it can recapture some of the export markets it has lost and couple that with the trade program where they will be able to move in and compete for this vast new growing outlet in the Common Market of Europe. Those are the issues involved.

I say that it is an act of foolishness, I say it is dangerous, I say we are taking a chance today that we should not take in saying to American industry whether it be big, small, little, or in between, or however you may describe it—in saying we are not going to give you any help whatsoever in this world situation we now face. That is what the situation is. I could go on and show you graphs and diagrams, show you the massive effects of this credit.

This credit is estimated at \$1.2 billion in tax revenue, but let me tell you what that means. That means that there must be many more dollars invested in order to get the credit. I know a lot of people who are now waiting to find out whether or not we pass this law as to whether they will go ahead and make these investments. Few people realize the extent of the effect that the help here provided will have. The stimulation will indeed be tremendous. Not only will we recapture the \$1,200 million but there will be a net gain in the future that will greatly exceed that figure, because for a company to gain a credit of 7 percent on a given amount of money they would have to invest many millions of dollars. That is the whole principle involved in this tax incentive program.

What happens if we do nothing? Let us examine that for just one moment. The rate of growth in our country last year despite all the so-called stimulation was something around 3 percent. The rate of growth in the six Common Market countries approached 6 percent. In our country last year—these are facts; I am not trying to gild them over—I know we continue to suffer from economic unemployment, but today in the six Common Market countries there not only is full employment, there is over employment. In Belgium, for instance, rather than there being unemployment, people are now what they call overemployed; they have more than one job. Some people have two jobs, some people have three. As a matter of fact, a few years ago, prior to the Treaty of Rome and the beginning of the Common Market, there was vast unemployment in Italy. Today, thanks to the free movement of workers from Italy to Belgium, to West Germany, and France, there is practically no unem-

ployment in Italy. Now, England, the United Kingdom, is reversing 500 years of foreign policy in deciding to come in as a full participating member of the Common Market. When England goes in there will be 225 million trained people, there will be a market as vast as the one we experienced in the original Common Market, called the United States of America.

In light of these conditions, in light of modernized industry in this new era, in light of the new political impetus operating in united Europe, are we to sit back and say to our industry, to our business people, our railroads, our transport industry, to our utilities, to our service industries, that we are not going to give you one iota of help despite these new conditions that prevail in the world in which we live today? That is what the motion to recommit will do and I trust when that vote comes at 4:15 this afternoon each and every one of you will remember that. The telegrams you have received, telegrams against the program, are telegrams hoping for a substitute. If this is voted down there will be no substitute and we will be confronted with a real economic crisis in our country.

There is one other matter I would like to deal with for a few moments. The other segment has to do with withholding. I do not like withholding. When I get a check over here from the Sergeant at Arms Office it is withheld on. A fellow who works in a plant is withheld on. If anybody who pays a nickel in wages, a part of it is withheld. We have worked out this proposition so that anyone who has no tax liability will have nothing withheld by the execution of a simple statement, pure and simple. In the case of elderly people it will amount to a very considerable sum of money, as you know, because of the special provisions and the exemptions provided to people who are old. In the case of young people 18 years of age and under there is an outright exemption. This means that the only people who can conceivably have any real complaint are those people who do not want to pay their taxes.

Mr. Chairman, this does not impose a new tax, this does not make a liability that does not exist now under the law as it is, under the Internal Revenue Code of 1954 drafted under the direction of the late distinguished and lovable gentleman from New York, Dan Reed, and I sat there and worked with him on it. Under that code this tax is due.

This provision is based on the fact that there is almost a billion dollars of taxes—\$850 million, to be exact—being evaded and avoided in this area, sometimes through negligence, sometimes through ignorance, oftentimes and unfortunately probably more frequently through fraud and dishonesty.

The CHAIRMAN. The time of the gentleman from Louisiana has expired.

Mr. MILLS. Mr. Chairman, I yield the gentleman 5 additional minutes.

Mr. O'NEILL. Mr. Chairman, will the gentleman yield?

Mr. BOGGS. I yield to the gentleman from Massachusetts.

Mr. O'NEILL. I think the remarks of the erudite, learned gentleman are to be

commended. I would like to know how do you answer the businessmen who are objecting to the fact that there is so much work going to be entailed in their operations by this change?

Mr. BOGGS. It is due to the system we are living in today. The so-called redtape involved here is less complex than the redtape involved in withholding on wages. The withholding system under the bill is efficient.

If there was any other way of getting this revenue nobody would be here advocating this. But here is the situation: We are doing this for justice to the honest taxpayer, for justice to the man who sits down and says, "Here is how much I earned. I do not like this tax. I think it is too high. Here is what I can claim in exemptions and in deductions and here is my check for what I owe the Government of the United States."

In justice to that honest man, I do not see how we can vote for this proposal which says we ought to knock that out of the bill and we are not going to knock out the other provisions.

Let us analyze the motion to recommit just a bit further. There are many things in this bill. There is one proposal which seeks to equalize the tax formula between the so-called stock insurance companies and the so-called mutual insurance companies. There is another proposal which seeks to equalize the formula between the so-called mutual thrift organizations, such as building and loan associations, and mutual banks and commercial banks. There is another provision in this bill which seeks to equalize the tax situation between the corporate entity paying 52 percent and the cooperative entity paying a different percentage. There are other provisions in the bill which seek to make some delineation on what a man can spend under the word "entertainment" or "business expense." There are other provisions dealing with incomes abroad. But, this motion to recommit deals with none of those. The people involved in all of these areas of taxation feel that in some respects, at least, they are being imposed upon.

The committee, in its wisdom, in its judgment, after months and months and months of hearings and executive consideration, decided on these formulas which, in its collective judgment, it feels are fair, equitable, and justified. But, now, all of a sudden, we are to be confronted with a motion to recommit. It says nothing about the co-op who complains; it says nothing about the mutual who complains; it says nothing about the hotel that complains; it says nothing about the big investor who complains, but it is taking a swipe to cut the throat of American business and protect those who are refusing to pay their just taxes by striking out withholding.

Mr. BYRNES of Wisconsin. Mr. Chairman, I yield myself such time as I may require.

Mr. Chairman, I was trying to get the attention of the gentleman from Louisiana to suggest to him that those who have complaints about these other sections of the bill which he referred to will have ample opportunity to express

that dissatisfaction on the final passage of the bill.

(Mr. VAN ZANDT asked and was given permission to extend his remarks at this point in the RECORD.)

Mr. VAN ZANDT. Mr. Chairman, in opposing H.R. 10650, a 240-page tax bill, I do so on the grounds that the bill has been amended in a halfhearted manner several times since being reported out by the House Committee on Ways and Means. It is still in my opinion an unsatisfactory bill. The amendments referred to were drafted hurriedly and rushed through the committee for the purpose of quieting criticism and in the hope of garnering sufficient votes to secure approval by the House of Representatives.

H.R. 10650 as reported by the committee left much to be desired. Even with the subsequent amendments, the bill is still bad legislation, and I intend to oppose enactment of it in its present form.

When voting on the rule which brought this bill to the floor of the House for 8 hours of debate, I voted in the negative because the rule is meaningless since no amendments are permitted except as part of the motion to recommit the bill.

The fact that the bill has been amended several times by the committee since it was reported out of committee, reveals the glaring weakness of the legislation. In addition, the closed or gag rule denies many of us the opportunity to amend the bill, and by so doing, to eliminate further complexities of our tax problem as well as a loss of revenue. The result is that the bill is being described as a budget buster, since in its present form it will actually decrease rather than increase tax revenue; thus, adding to our national debt which is now \$300 billion and since January 1961 has been increasing at the rate of \$1 billion monthly.

The section of H.R. 10650 which has attracted the most criticism from my congressional district is the proposal to withhold taxes on interest and dividends. Speaking frankly, in order to pay part of the tax bonanza to business, many millions of our people who have a savings account, a share of stock, or an insurance policy, or who belong to a cooperative, will be subjected to withholding on the interest or dividends they receive. According to the Commissioner of Internal Revenue, when we count only payments of \$10 or more, there will be more than 350 million savings and shareholder accounts alone that will be subject to withholding.

If Mrs. Jones has a savings account of \$100, instead of getting at 4 percent \$4 interest credited to her account, she will get only \$3.20. The bank will send 80 cents to the Treasury. The bank will not, however, tell the Treasury whose account this 80 cents was taken from. To get the other 80 cents, she will have to go through the redtape, trouble, and expense of filing an exemption certificate every year or filing for a refund. She will have to do this even though she owes no taxes.

This provision will produce massive overwithholding and will be an administrative nightmare not only for these millions but also for the banks, savings and loan associations, cooperatives, corporations, insurance companies, and the Internal Revenue Service.

In my study of this particular provision, many experts on tax laws insist that the bill in its present form is "full of bugs," principally because the proposal on the withholding of interest is not all inclusive since no provision is made for interest withholding by private lenders—those other than banks and corporations who lend money. My source of information tells me that such exceptions would encourage loan sharks and fly-by-night operators in the credit field.

Mr. Chairman, after reading most of the hearings and listening to the debate on the bill I am convinced there is still much confusion in the minds of many of us as to the actual intent of the legislation. Therefore this bill should be returned to the House Committee on Ways and Means for further hearings. We still have ample time left with several months ahead of us before adjournment and for that reason a further effort should be made to bring to the floor of the House a bill stripped of confusion and inequities, and one that will promote tax equality in the truest sense and yet produce badly needed revenue for our Government.

Mr. KNOX. Mr. Chairman, I yield myself 15 minutes.

Mr. Chairman, the bill we are now considering contains several gross inconsistencies with other administration programs and fails to take adequate and proper notice of the economic facts of life applicable to this Nation and its world position. The Revenue Act of 1962 has been billed by administration spokesmen as the first step in a program of sweeping tax reform. Reforms usually are considered to be attempts to improve that which is being reformed. While the bill before us strikes off in the wrong direction from any number of standpoints, I intend to discuss here only a few of the more unwise and unjustified measures being advocated.

Section 19 of this bill, which deals with withholding on dividends and interest at a flat 20-percent rate will, in operation, result in approximately \$600 million of increased revenues if Treasury Department estimates are correct. This would be fine except for a number of things. First, this increased revenue will to a significant extent stem from unjust enrichment of the Federal Government at the expense of unsophisticated taxpayers who have no tax liability. The Internal Revenue Service will in effect slip its fingers into the pockets of millions of Americans, remove small sums to which it is not entitled and hope that these taxpayers will not notice and ask a refund, and then attempt to justify this confiscatory action on the grounds that the millions of dollars gained in aggregate are partially balancing out other provisions of this bill. This concept of so-called tax reform is completely

repugnant to any sense of equity or justice in our manner of tax collection. It is precisely this type of concealment of hidden charges that President Kennedy complained of in his message on consumers the other day. Yet we have in this bill an administration proposal that the Federal Government should set the questionable example of following a hidden-charge policy—a policy of taxation without tax liability; for who is to doubt that literally millions of small shareholders who have no tax liability will have tax withheld but no tax refund.

I can find no protection for the consumer in this attitude. I submit that before our Government starts demanding better treatment of the consumer on the part of the so-called private sector we had better start showing some concern in the public sector for better treatment of our taxpayers.

Second, this withholding proposal will tend to have a stifling effect on our economy by blunting the incentive to invest on the part of millions of small investors who will be discouraged from investing by the administrative complexities of this section. This factor alone could offset any benefits estimated to accrue from this section of the bill. In addition this blunting of capital available to strengthen the upward thrust of the economy could well result at a time when a much faster growth rate is vitally necessary.

Third, the proposal to withhold interest and dividends would work a hardship on the millions of small investors who depend upon this income as a vital supplement in providing for their daily needs. Only through filing papers and more papers saying they expected to pay absolutely no tax for the coming year could they hope to have the use of these funds on a timely basis throughout the year.

Finally, this withholding portion of the bill will result in an administrative monstrosity and add further complications to an already overly complex tax reporting system. It is, as is pointed out in the committee report, conservatively estimated that half a billion accounts will be affected by this proposal. To be sure many of these will involve only nominal amounts, but it is precisely these accounts which the Treasury impliedly expects that citizens will forget. However, if they refuse to overlook this Treasury pickpocket attitude I mentioned earlier, it is obvious that a great deal of time and expense will be expended in correcting the massive overwithholding. In addition, the taxpayer affected is going to have a difficult time in determining what if any refund he is entitled to since the bill provides for no certificates similar to W-2 forms for the citizen to use to substantiate his claims. Further, a "break" is given to the big investor which is inequitable, in that he, even though he should be taxed at a higher rate, will only have taxes withheld at the 20 percent rate.

While I certainly feel that income properly subject to taxation should be reported, the withholding proposal ad-

vocated in this bill will be, if adopted, questionable in revenue effects, inequitable in operation, and result in compounded confusion and an administrative nightmare. There are better ways of correcting any underreporting in this area without deliberately imposing a system that will inevitably result in over-withholding.

Now—the investment credit provisions as contained in section 2 of the bill will fall far short of the boost for our economy that its supporters claim for it, and at the same time will contribute substantially to another monstrous Federal deficit for fiscal 1963. The combination of adverse effects of this bill could literally cause irreparable harm.

This provision of the bill has been soundly opposed by nearly every major segment of our economy. The reasons for this opposition are plain. To begin with, this proposal will not result in any great boost for our economy, nor will it result in any substantial modernization of our Nation's manufacturing equipment. What it will do is provide a "windfall" for a relatively small portion of our economy and provide no incentive to further invest whatsoever for vast segments of it. The provision will greatly reward those companies which have done little or nothing over recent years to keep up-to-date in modernization, and will in effect penalize the most forward-looking firms. In addition, the provision completely ignores the service and distributing segments of the economy.

A far wiser, more equitable, and vastly more beneficial course of action, both from the standpoint of immediate effect and long term results would be to undertake a significant overhaul of the depreciation rates and schedules and provide inventory tax deferrals as outlined in the minority views of the committee report and embodied in the bill, H.R. 10608, introduced by our esteemed colleague, the gentleman from Wisconsin [Mr. BYRNES].

Of course, one standout factor in the administration's proposal on investment credit is the adverse effect it would have on the budget balance for fiscal 1963 and subsequent years. The effect far outweighs the minute plus factor the provisions could add to our Nation's economy. Before we recklessly cut our Nation's tax revenues in the face of enormous increases in Federal spending, we should take all measures necessary to determine that the proposal will have a beneficial effect on our economy of considerable proportions. This would not be the result of the present investment credit provision in the bill before us. This provision was adopted by a majority of the committee despite overwhelming testimony against the proposal and clear cut indications of the far more desirable effects of basic depreciation reform both as to schedules and rates. This testimony came from tax experts and economists from nearly every segment of our economy as outlined in the minority views. The end result of the majority decision of the committee is to force a watered-down, unwanted administra-

tion proposal down the throats of business.

I highly recommend to the House that we approve the motion to recommit the bill directing the Committee on Ways and Means to eliminate section 19 which provides for the withholding of interest and dividends, and section 2 the investment credit provision. By this action the House would be easing the tax burden of the taxpayers and producing a savings of \$940 million in the fiscal year just ahead, which begins July 1, 1962. We would then have a truly revenue producing bill and not a revenue loss of just short of \$400 million dollars in fiscal 1963.

Two sections of the bill dealing with the taxation of oversea income, sections 11 and 13, the so-called gross-up and U.S.-controlled foreign corporation taxation proposals are unjustified in concept and dangerous in contemplated operation. These provisions will further handicap the ability of U.S. businessmen to compete in world markets. The net result of these provisions will be to injure U.S. business at home, increase vastly the cost of doing business overseas, violate innumerable reciprocal tax treaties, and vitiate any attempt by this administration to make this Nation more competitive in world markets. It would wrap our corporations which have foreign subsidiaries in a choking cloak of redtape and burden them with additional taxes that their foreign competitors do not face. It is, as the minority report points out, "isolationism at its very worst." It would rob many of our companies of the benefits of patents and processes now used to this country's advantage. It would expose the economies of our free world allies to Communist economic exploitation to our direct detriment. It would be inequitable in that it would impose double taxation on foreign income but would provide for no similar Government share in bearing of losses in foreign ventures. It would break faith with hundreds of U.S. businesses which this Government has encouraged and induced to expand overseas in an effort to speed developments of those nations. It would greatly impede development of the emerging nations in that U.S. firms could no longer invest with confidence because they would have no assurances that they would not be discriminated against by Presidential decree that that nation was no longer on the qualified list of underdeveloped countries. Thus, this provision runs exactly contrary to every foreign policy statement of this administration and previous administrations, and throws a shadow of grave doubt on the sincerity of Kennedy administration statements about wanting to make this Nation competitive in the world of today and tomorrow.

We are hearing much talk in this session of the Congress about the need to improve America's economic strength both at home and abroad. The Committee on Ways and Means is presently conducting hearings on the President's tariff proposals. One thing is becoming increasingly clear. Tariff revision alone

will not make this Nation competitive in world markets. All it alone will do is open this Nation to a flood of imports, while we hope to obtain similar lowering of tariff walls abroad. A vital ingredient in any effort to improve our position is missing, and it is the true key to expanded trade and economic growth. This key is basic tax reform. The need is patently and plainly evident that we must clarify and simplify our tax system, not add further confusion. We must provide sound, logical tax programs that will enable our firms, be they of manufacturing, service or distributive nature, to modernize and expand to the maximum degree possible. We must remove a significant portion of the overwhelming tax burdens our businesses bear, so that we do not send them into the world trade battle with their hands tied behind their backs. If we are to accept the challenges and promises for the future offered by an expanding European Common Market, by an increasingly competitive Japan, by rapidly industrializing and modernizing nations all over the globe; if we are to realize fully the vast potential inherent in this Nation, then we must do one thing. We must, beginning right now, stop harassing, hindering and handicapping our American free enterprise system and start giving it the freedom and encouragement it needs.

Mr. KUNKEL. Mr. Chairman, will the gentleman yield?

Mr. KNOX. I yield to the gentleman.

Mr. KUNKEL. What I would like to know is how they arrived at their estimate of how much money they have lost by the failure of these people to pay taxes. How can they get any kind of an accurate slant on that?

Mr. KNOX. The question was asked by the committee at the time representatives of the Treasury Department appeared before the committee. Through their actuaries they claimed that there was approximately \$600 million that was lost revenue. How they determined it, we would have to find out from the actuaries, or perhaps some other member of the committee may have access to that information. I do not.

Mr. KUNKEL. Mr. Chairman, will the gentleman yield further?

Mr. KNOX. I yield to the gentleman.

Mr. KUNKEL. If they know that that revenue has been lost, why do they not collect it?

Mr. KNOX. Of course, they have the tools to collect it. If this was actually a loss, they should have made an effort to collect it.

Mr. KUNKEL. If they can make an accurate estimate, then why can they not make the collection?

Mr. KNOX. They certainly have all the tools to go ahead. They have, in the Internal Revenue Service, all of the investigators and auditors, and so forth; and, of course, if they are not astute enough to go out into the field and do the job, then it is not the responsibility of Congress to do the job for them, a job which rightfully belongs in the administration.

Mr. WIDNALL. Mr. Chairman, will the gentleman yield?

Mr. KNOX. I yield to the gentleman.

Mr. WIDNALL. Does the gentleman have any estimates of the windfall, the bonanza that would be given to companies such as the Telephone company and International Business Machines?

Mr. KNOX. I am reluctant to name any specific companies, but it is true that it runs into hundreds of millions of dollars.

Mr. WIDNALL. Mr. Chairman, will the gentleman yield further?

Mr. KNOX. I yield further.

Mr. WIDNALL. I ask this question as I happen to be a stockholder in both companies. I think it is dead wrong for either one of them to get any money out of this bill, because of the fact that they have proven in the past their ability to finance every blessed program they want. This is force feeding to companies that do not need it. It gives them a tremendous tax windfall.

Mr. KNOX. I agree with the gentleman. Of course, some companies, such as those the gentleman has mentioned, have made it publicly known that they were not interested in the so-called 7 percent credit.

Mr. WIDNALL. I thank the gentleman.

Mrs. CHURCH. Mr. Chairman, will the gentleman yield?

Mr. KNOX. I yield to the gentleman from Illinois.

Mrs. CHURCH. Mr. Chairman, I must at the beginning make honest confession: I am certainly no tax expert, as are the members of the Ways and Means Committee of the House. One statement however can be made with equal truth. After I sat here yesterday for 4 hours listening to the pros and cons expressed on this legislation, it was evident to me that my worst fears were justified as a taxpayer of this country, which is, of course, what I am. And there are millions like me who have long merited relief from, rather than addition to the tax burdens, which profligate congressional spending has placed on this country.

As I watched the deliberations of the House Committee on Ways and Means, which I honor and respect, over a period of many months, I became convinced, from the testimony of those in my district who thought that they might be adversely and unjustly affected, and of all in my district who feared that the eventual bill might not even meet its announced goal, that this Congress must examine the legislation closely and discriminately. The discussions here yesterday and again today, equally convince me that the committee has brought out on the floor a bill that is inequitable and discriminatory and in itself bound not to serve the purpose of a revenue bill. The purpose of a revenue bill is either to increase revenue or to so stimulate the economy as to make available more tax money as well as more income for the people. This bill will do neither. I regret that in the brief time allotted to me, I cannot in detail expose the full weaknesses and dangers inherent in its passage. I would say to the

gentlemen, whose work on the committee I also greatly admire, that unless this bill is improved through the motion to recommit, I shall certainly vote against it. In fact, considering the other features of the bill which we have been denied the right to change by amendment or to make good substitution for, I am inclined at this moment to assure the gentleman that I will vote against the bill anyway.

Mr. KNOX. I concur in the views expressed by the gentlewoman.

Mr. Chairman, I reserve the balance of my time.

Mr. Chairman, I yield 5 minutes to the gentleman from New York [Mr. FINO].

Mr. FINO. Mr. Chairman, at the very outset, I want to say that I am opposed to this tax-reform bill and will vote against it.

Under this bill, a tax break is proposed, not for the hard-pressed American taxpayers who sorely need tax relief, but for businesses which invest in machinery and equipment for expansion purposes. Of course, this tax credit to business will mean a tax loss to our Treasury amounting to over \$1 billion. So to recoup this loss it is proposed in this bill that we increase tax collections, and this, in substance, amounts to a tax bill.

There are two proposals in this tax bill which are very objectionable. The first one is the proposal to impose a heavier tax on mutual savings banks and savings and loan associations. This would certainly have a serious and disturbing effect on the whole home-building industry in this country.

This tax, if it goes through, will cut deeply into the net profits of these associations by lowering the net earnings and thereby threatening the rate of return they pay their depositors who alone share in these earnings.

We all know that the mutual thrift institutions are the primary source of mortgage funds that finance the building and buying of homes. This proposed tax will reduce the savings and thereby constitute a threat to the availability of mortgage funds for home construction in the United States. It will force interest rates on mortgages to a higher level which will discourage the demand for housing loans. A seriously retarding effect on the national economy will be the logical consequence.

The other equally objectionable part of this legislation is the proposal to withhold Federal income tax on interest and dividends. For many years, tax administrators, legislators, and other economists have echoed the warning that the tax structure should be simplified. Yet, we have before us a proposal which leads us away from simplicity. Millions of additional operations would have to be performed both by taxpayers and the Government in order to carry out this proposal.

This administration would lead us to believe that the withholding system will be a simple procedure with little additional compliance and administrative cost. However, if we look into the actual mechanics of operation that will be required, we can readily see that it

will be far from simple. Take the case of the banking financial institutions, for example, who have millions of depositors. These institutions will be required to make millions of withholding entries on these records. Even exempting individuals under 18 and over 65 years of age, will not lessen the job to any great degree. On the contrary, it may cause additional confusion and work, because the institutions will be confronted with handling numerous exemption certificates.

Furthermore, although not compelling under the proposal, good business practice will require the institutions to spend time-consuming efforts in informing the interest recipients about the operation of the provision. Notification to the depositors as to how much has been withheld from their interest payments will be necessary. In some cases the banks and other associations will even have to help depositors fill out their income tax returns to reflect the withholding properly.

This problem will be accentuated, because individuals will be discouraged from depositing their funds in banks and savings institutions. They will be reluctant to become involved in the withholding procedures. They will be more inclined to shift their savings to tax-exempt and tax-deferred investments, or to spend most of their small surpluses which they might otherwise save. Thus, thrift would be relegated to a low priority.

The impact on life insurance companies will be one of additional cost of operations. This not only will be adverse to the industry but also to the economy in general. Even on simple accounts the insurance companies will face costly bookkeeping expenses of recording the amounts withheld from accounts. Other transactions will create more serious and costly problems. Certain contractual arrangements such as policyholder dividend accumulations, interest added to certain death benefit payments, and interest paid under death benefit settlement options will require more extensive bookkeeping operations.

We must remember also that life insurance companies depend largely on earnings from investments to meet their contractual policy commitments. The life insurance industry has estimated that withholding 20 percent of its investment income from dividends and interest will deprive it, for varying periods of time, the use of about half a billion dollars over a period of 12 months. This in turn will deprive the economy of these much needed funds.

There are an estimated 15 million stockholders, most of them wage earners, in the United States. Accounting entries must be made by the distributing corporation to show the extent of the withholding of tax on their dividends. It takes little imagination to realize the cost of this kind of a system to a large company such as the American Telephone & Telegraph Co., which has nearly 2 million shareholders, or to the United States Steel Corp., which has about a third of a million shareholders. Furthermore, even though most small cor-

porations will have many less stockholders than the giant corporations, the additional cost to them may be relatively more burdensome, and deprive them of a relatively greater portion of needed capital.

Serious skepticism has been raised by well-informed groups about the validity of the estimated revenue loss that presently results from unreported interest and dividends. Thus it would be foolhardy to embark now upon such an undesirable program of withholding. At least the decision whether or not to impose such a system should be held in abeyance until the public is given greater assurance of the reliability of the estimates. This is important for at least two reasons. First of all, unless it is clearly demonstrated that this evasion does in fact exist to the extent alleged, the business community should not be subjected to administrative burdens which will certainly be difficult to rescind. Secondly, we have spent little time in allowing our educational program in this area to work. The educational program to which I refer is the practice of interest and dividend payers notifying the recipients of their legal tax liability on these forms of income. Moreover, we are now establishing a nationwide automatic data processing system which should ferret out tax evasion methods. This is a taxpayer number and electronic computer system to make sure that dividends and interest are reported.

I dread the thought that we might embark on a program of tax withholding on interest and dividends before we have had a satisfactory test period for the educational and automatic data processing programs. Such a withholding system would result in unnecessary business expense, additional governmental administrative costs, individual taxpayer hardships, and retarding effects on the economy. A proposed program that would have these undesirable results is one that must be unequivocally defeated.

The ill effects and the hardships this bill will cause are too great to justify its passage or even to warrant further consideration. I urge the Members of this House to vote against this bill.

Mr. KNOX. Mr. Chairman, I yield 15 minutes to the gentleman from California [Mr. UTT].

(Mr. UTT asked and was given permission to revise and extend his remarks.)

Mr. TEAGUE of California. Mr. Chairman, will the gentleman yield?

Mr. UTT. I yield to the gentleman from California.

Mr. TEAGUE of California. On pages 166 and 192 of the bill before us providing for a tax on farmer cooperatives and providing for the withholding of patronage dividends, REA cooperatives are obviously excluded and exempted. I call this rank and inexcusable discrimination.

Mr. UTT. Mr. Chairman, I would like to open my remarks by quoting a statement made by the present chairman of the Ways and Means Committee when he was debating the tax revision bill of 1954:

Mr. Chairman, I find myself today in a position that I do not relish because of the great affection I have for the Chairman of the Committee on Ways and Means and all the members of the committee, many of whom are in disagreement with the position I shall take on this bill.

May I say, Mr. Chairman, that the gentleman from Arkansas expressed the sentiments which I have today.

Further quoting the gentleman from Arkansas, on page 3525 of the permanent CONGRESSIONAL RECORD of March 18, 1954, he stated:

This bill is taxing for another year at the present 52-percent rate all the corporations in the United States that earn money, but as a handback with the other hand in the same taxable year, \$619 million goes to corporations that can qualify for these enlarged benefits that are extended under the bill in the form of additional depreciation and in the form of loss carrybacks and so on, and even depletion is affected here in some instances for some corporations. But the great majority of the corporations in the United States, Mr. Chairman, have received no tax relief since this administration came into office last year.

The majority of the Ways and Means Committee has presented a tax bill which does exactly what the gentleman from Arkansas so abhorred in 1954.

Mr. Chairman, I wish at this time to call your attention to some of the statements made by the Democratic Members of the House Ways and Means Committee during the debate on the tax revision bill of 1954 with specific reference to investment incentives. Mr. Forand made the following statement on the floor of this House:

The Republican program, as enunciated by the President, and as set forth in this bill, provides for a return to the theory of Alexander Hamilton and later Andrew Mellon—a theory that places property rights ahead of human rights; a policy of trickle down—that is, the idea that if you take care of those at the top of the economic ladder, the benefits eventually will trickle down to those at the bottom. That theory was used in the 1920's and resulted in the never-to-be-forgotten depression of the early 1930's.

Emphasis is being placed on the need for incentives to business to increase productive capacity. That would be wise in normal times. But we know that today we have more production than we can consume. What we need right now is consumer dollars, so that goods will start moving, and thus create a demand for more production. Raising exemptions will mean more consumer dollars. Evidence of the need of this is all around us.

The following is a statement made by Congressman Eberharter on March 17, 1954:

Of course, Mr. Chairman, we have succeeded in doing this; we succeeded in alerting the people of the country to the fact that this is a tax bill slanted in one direction. When you look at the figures and search through them, instead of all this smokescreen and talk about incentive, when you get down to the cold facts and figures, you cannot help but conclude that 90 percent, at least, of the benefits of this reduction will go to those who are best able to pay taxes.

I am now going to quote some statements made back in 1948—CON-

GRESSIONAL RECORD of February 2, 1948, page 915—by the late Speaker, the Honorable Sam Rayburn:

I know this, and I repeat it, that if something disturbs our economy and we do not have this great national income to pay taxes upon, this tremendous debt of \$250 billion is going to press down on your dollar and mine and is going to squeeze the value out of that dollar and it will be worth less than it is now.

Those who would recklessly cut taxes at the risk of deficit spending may, indeed, be endangering their country to enemies, both foreign and domestic, against whom they have sworn to protect and defend."

The gentleman from Massachusetts, Representative PHILBIN, stated also during the debate in 1954:

Tax bills, like other bills, should be determined on principles; not upon sheer expediency. Call it the trickle-down theory, or whatever you will, any measure based on promoting the prosperity of the privileged group and the vested classes in order thus to permit better conditions and standards for wage earners, small businessmen, farmers, and workers, and the rank and file must be considered, I think, basically unsound, not only as it relates to the principles of social justice, but also as an effective revenue-producing mechanism. I must reject such a shortsighted, outdated policy as well as its underlying philosophy.

Mr. Chairman, I now wish to quote a statement by the present Speaker of the House, the gentleman from Massachusetts, which he made and is recorded in the permanent CONGRESSIONAL RECORD of March 18, 1954, on page 3550:

There is a clear, sharply cut issue here; whether or not the Members of the House are going to vote for the trickling-down policy, whether or not there are enough independent Republicans who will vote against that policy. It is a question of the trickling-down policy on the one side and the policy of the Democratic Party of helping the people generally, on the other side; of starting at the base rather than starting at the upper levels. That is a clear-cut issue which cannot be denied. When we vote in a comparatively short time, that is going to be the issue. From my experiences with the trickling-down policies of the Republican Party, in past years, I should say that very little has trickled down to the people.

I know that pressure has been brought upon my Republican colleagues. I am not going to comment harshly upon that. But if there were a Democratic President and the same kind of pressure were being exerted upon the Democrats, the Republicans would be hollering to the high skies.

While there are provisions of the pending tax bill that I favor and support, if the motion to recommit is defeated, because of the inequitableness of the bill from an overall angle, I cannot in conscience vote for its passage.

I hope that the sound policy of the Democratic Party in the people's interests will be supported by a majority of the Members of the House today.

Mr. Chairman, the main reason that I have referred to the debate in 1954 with specific reference to the trickle-down theory of aid to business is because every campaign I had following 1954, I was dubbed as "Trickle-Down Utt," who only wanted to help the economic royalists. We have before us today a bill which not only helps the economic royalists by the benefits to

them but clobbers the little taxpayer throughout all America, not only by adding to the tax liabilities but loading him down with paper work to defend himself against massive over-withholding. All of the remarks which I have just quoted support the Republican position on the current tax bill.

Now, Mr. Chairman, I shall direct my remarks to section 13 of the pending bill, which deals with the tax treatment of foreign based subsidiaries. We had a liberal discussion opposing tax loopholes in so-called tax havens, and then without any hearings we proceeded to expand the tax treatment of these subsidiaries without any public hearings and without any information from the administration, as to the collateral economic impact upon these foreign based subsidiaries.

Section 13 might well be entitled "The Fast Buck Section for the Temporary Benefit of the Treasury." I say this because we are proposing to kill the goose which lays the golden eggs, and our foreign based subsidiaries will not be able to meet the competition of other foreign corporations operated in the same field. Our foreign based subsidiaries were given this tax treatment to permit them to compete in the foreign field.

One of the arguments which has been repeatedly advanced in support of the imposition of a new U.S. tax against the operating income of our American subsidiaries in developed foreign countries is that these firms send more U.S. dollars abroad than they bring home to the United States.

But the fact is that this allegation is entirely contrary to the mass of evidence which was presented last summer on this subject to our committee. In case after case, witness after witness spelled out to us the infirmity of these claims as applied to specific U.S. subsidiary operations in these countries. In addition, a little-noticed study by the Department of Commerce confirmed that these findings as to particular companies are true overall as well. Finally the very latest Government figures on the balance of payments, released only last week by the Department of Commerce, show that in 1961, during the very time when Government witnesses were presenting their foreboding predictions to our committee, the balance of payments situation—as influenced by these subsidiaries—was in course of rapid improvement, even in developed markets such as Western Europe and Canada.

Before expanding in some detail upon these considerations, I should like to point out that the Treasury Department's attempt to segregate the so-called developed countries from less-developed areas of the world for balance-of-payments purposes is entirely unsound. One illustration will suffice: Many of the major U.S. oil companies are integrated on a worldwide basis. Outside of the United States, they derive their raw products, by and large, from the less-developed areas of the world. In the main, they market these products through subsidiary corporations in the developed areas of the world. More than

70 percent of the products produced abroad are marketed abroad, chiefly in Western Europe. To market these products in Western Europe they must build refineries, pipelines, distribution facilities, and gasoline pumps in Europe. Nearly 50 percent of our current investment in Europe is in this kind petroleum investment. Now, obviously, if we restrict these European investments through new taxation, we will retard not merely the ability of these firms to expand competitively within these foreign markets, but also we will literally shut down some of the wells in the less-developed countries of the world, countries we are trying to aid through such things as the alliance for progress.

Leaving this basic fallacy aside, however, the figures presented to our committee show that, on a developed country basis alone, our foreign subsidiaries contribute substantially to our balance-of-payments account. A summary of data presented by 19 companies covering the 4 years 1957 to 1960 show this in striking fashion. These firms, chiefly operating through subsidiaries in developed countries, in 1960 alone contributed over \$600 million net to our balance of payments. Their combined dividend repatriations, repatriated royalties and fees and U.S. exports traceable to their oversea investments, amounted to nearly \$700 million in that year, while the outflow of new capital from the United States and their imports from abroad were substantially less than \$100 million. Why do we want to inflict new competitive burdens upon these highly desirable operations?

Let me give you another illustration of the kind of subsidiary operation overseas which would be caught up and placed in a straitjacket, sacrificed to theories not compatible with the facts. International Telephone & Telegraph is the largest American-owned international enterprise in the electronics and telecommunications field. It is 92 percent owned by 90,000 U.S. shareholders. Its operations are two-thirds abroad and one-half in Europe—so that the proposed legislation would have an unusual impact on this company.

It operates 22 plants and laboratories in the United States in the States of California, Illinois, Indiana, Massachusetts, Mississippi, New Jersey, Rhode Island, Virginia, Missouri, and North Carolina, and it is about to break ground for one in Tennessee.

It employs 22,000 people in the United States and the payroll of these U.S. companies since inception has been approximately \$1 billion. These companies were started with and supported by foreign capital and earnings. These earnings were, moreover, U.S.-taxed on repatriation before investment.

In Latin America, it operates 13 plants, laboratories, and radio and telephone operating companies in 8 countries. It has 17,000 employees in this area. The value of its assets there at replacement would approach \$300 million. It has been an average of 33 years in these countries, in Argentina for 36 years. These are underdeveloped countries, and

its plants were largely financed by European earnings. Again, such earnings were U.S.-taxed on repatriation before investment.

It has other plants in Australia and sales and communication operations throughout the Far East.

In particular, in Europe, it operates 70 plants and laboratories in 14 countries. These are operating plants, not sales offices, in every country in Europe except Luxembourg. It has 93,000 employees in Europe. Its assets at cost in Europe approximate \$450 million. It has been in these countries for an average of 36 years; one company in Belgium has been in business for 79 years. These companies have largely financed themselves through partial reinvestment of earnings and local borrowings in Europe. This growth has enabled them to finance United States and Latin American development as well as their own.

ITT's foreign subsidiaries have remitted 50 percent of earnings except when blocked by currency restrictions. They have remitted net \$215 million to the U.S. economy in the last 10 years—\$166 million of it from Western Europe alone. In 1960, these subsidiaries remitted \$48 million of which \$34 million came from Western Europe.

ITT has incurred serious risks and losses in exposed positions during World War II and recently in Cuba. Its stockholders have taken the brunt of these risks in all these periods. It maintains an export surplus from the United States.

Over the past 10 years this export surplus has been over \$175 million net, \$100 million of which is directly traceable to its own foreign companies, and the majority of the remainder is by reason of its established position in the countries to which it exports from the United States.

What possible justification could exist for the United States reaching into these foreign operating companies and imposing a new U.S. income tax which the local competitors in these growing markets will never have to pay?

A special survey by the U.S. Commerce Department permits a more complete story to be told. Thus study covered operations of 155 U.S. manufacturing companies, located mainly in developed countries. The study, in turn, is backed by examples of actual experience of individual American companies.

Note that these 155 companies, on an overall basis, returned to the United States from their manufacturing subsidiaries \$1.3 billion more than they withdrew from the United States in 1960.

The operations of these companies thus are shown to have added to the financial strength of the United States. Supplies of dollars in this country were built up, not drained away.

The Commerce Department survey covered a large sample of manufacturing companies. If all American companies abroad were counted—from trading subsidiaries to oil drilling—the favorable effect on the United States shown by the Commerce survey, industry officials said, would be much larger.

For example, these officials estimate that all U.S. companies overseas buy a total of \$5 billion worth of American goods each year—as against only \$1.8 billion worth shown in the sample survey.

Similarly, total payments to the United States from foreign-earned royalties, license payments, management fees and the like are estimated to be running at the rate of \$400 million annually—as against only \$148 million shown in the manufacturing survey.

Finally the latest balance-of-payments figures published by the Government in the March issue of Survey of Current Businesses show that, during 1961, there has been substantial improvement in the ratio of repatriation of dividends to new capital outflow, even in the case of Western Europe and Canada which are the world's most developed countries aside from the United States. The figures just released by the Department of Commerce—"Survey of Current Businesses," U.S. Department of Commerce, March 1962, page 22—for Western Europe and Canada, which are the only figures separately published for developed countries, found that the level of 1961 repatriation of the income to the United States is almost exactly in balance with the new outflow of direct investment capital. In other words, the new outflow in 1961 amounted to \$973 million, while repatriated income was \$968 million in that year. These figures do not, of course, include exports from the United States which are generated by the existence of these investments overseas.

I referred earlier to the special survey of 155 major firms for 10 months of 1960 in which the Department of Commerce found that such exports to Western Europe alone for 10 months of 1960 amounted to approximately \$712 million and exceeded imports to the United States from such sources sevenfold.

I note that the majority of the Ways and Means Committee in its own report on this tax bill found as a fact that—and I quote:

The location of investments in these (developed) countries is an important factor in stimulating American exports to the same areas (p. 57).

I call your particular attention to remarks of Secretary of Commerce Luther H. Hodges prepared for delivery March 16—less than 2 weeks ago—at the Eighth Annual Business International Washington Roundtable.

The Secretary says:

While the basic aim of our tax policy is to stimulate domestic growth, we are not unmindful of the problems faced by U.S. subsidiaries abroad—including the problem of competing with foreign companies subject to different total tax obligations.

U.S. investment abroad is important to our export expansion program. Direct investments in manufacturing facilities abroad stimulate our exports of capital equipment, our exports of parts and raw materials, and our exports of finished products to fill out the lines of subsidiaries producing and selling abroad.

To the extent that U.S. investment abroad increases the financial strength and the competitive capacity of American companies, it reinforces our domestic economy. And, to the extent that the earnings on these investments are returned to the United States,

they make a direct contribution to improving our balance of payments.

In my judgment, it would be very foolish for the United States, at the very moment when the Common Market we encourage is moving into high gear, to place obstacles in the way of our firms getting established in that profitable market. I have no doubt that if we enact this bill and place these tax obstacles in force, we will worsen our balance of payments in due course, because we will destroy the foundations of future profit from these markets. As far as revenues are concerned, we might get a little bit more tax revenue for a short time. In the longer pull, however, we will curtail the growth of our firms in these new markets and our tax revenues will unquestionably be less than they would have been if we never had erected the obstacles in the first place. For these reasons I think it would be a tragedy if the House should pass this pending tax legislation.

Mr. KNOX. Mr. Chairman, I yield such time as he may desire to the gentleman from Nebraska [Mr. BEERMANN].

(Mr. BEERMANN asked and was given permission to extend his remarks.)

Mr. BEERMANN. Mr. Chairman, the Ways and Means Committee has written into the Revenue Act of 1962 a provision for taxing the dividends of farmer cooperatives which, if enacted, will violate the fundamental rights of millions of farmers.

This substitute provision, which displaced a perfectly fair provision for taxing co-op dividends, states that if the bylaws so provide, a co-op may retain dividends and patronage refunds indefinitely but the farmers must pay the tax. This means that a co-op may declare a book dividend of \$100 for the year 1962, keep the money for working capital, and make the farmer pay the income tax. It may do the same for the fiscal year 1963, and again the year after that, and keep on doing it for as many years as it likes.

Now, I am a farmer and familiar with co-ops and I know that no farmer in his right mind would think of giving the co-op managers the taxing power which the Ways and Means Committee now proposes to give them by law.

It is no answer to say that the farmer can quit the co-op if he does not like the bylaws. In practice, millions of farmers have no such choice. For them, membership in the local is a necessity, not a choice. In some great agricultural areas, and in the case of many farm products, especially fruits and vegetables, practically the entire marketing facilities are in the hands of the co-ops. The farmer who tried to operate outside the co-op framework would find himself without buyers and without marketing facilities. His only alternative would be to stay in the co-op or quit farming.

The original provision for taxing co-op dividends, which the Ways and Means Committee first wrote into the Revenue Act, was fair to the farmer, fair to the co-ops, and fair to the Government which is entitled to some tax revenue from co-ops profits. The original bill provided for a three-way option. The farmer could agree to pay the tax and let

the co-op keep the money; or the farmer could tell the co-op if it wanted to retain the money, it would have to pay the tax; or the farmer could get the money and pay the tax.

I am delighted that the American Farm Bureau Federation, which is always on the alert to guard the real interests of the farmer, promptly announced its opposition to the new co-op tax section of the Revenue Act. Said the Farm Bureau:

In our opinion, this procedure does not adequately protect the rights of the individual farmer member.

I would concur in that statement and add that Congress would be far wiser to enact no legislation at all on co-op taxation than to accept what the Ways and Means Committee has written into the bill.

Mr. FINDLEY. Mr. Chairman, will the gentleman yield?

Mr. BEERMANN. I yield to the gentleman from Illinois.

Mr. FINDLEY. Mr. Chairman, I desire to associate myself with the gentleman's statement and commend him on it.

(Mr. HARVEY of Indiana asked and was given permission to extend his remarks at this point in the RECORD.)

[Mr. HARVEY of Indiana's remarks will appear hereafter in the Appendix.]

Mr. MILLS. Mr. Chairman, I yield such time as he may desire to the gentleman from Michigan [Mr. LESINSKI].

Mr. LESINSKI. Mr. Chairman, I am disappointed in the tax bill which has been reported by the Committee on Ways and Means, for I had hoped that the Congress would enact this year a general revision of the tax laws of a much broader scope to eliminate all the various loopholes and special concessions and, most important, to give relief to the hard-pressed individual taxpayer and small businessman, such as I had proposed early in this Congress in my bill, H.R. 244.

It is advocated by some economists that when an economy needs stimulation, the Government should either increase Federal spending or cut taxes. Either course calls for deficit spending, which I am not advocating as a standard practice, but which I recognize as a necessary evil in an emergency if there is sufficient justification for it. I believe justification for it has been shown by the administration in its recommendations for various spending programs and by H.R. 10650 which, if enacted, will assist the economy of the Nation.

I would propose, therefore, that Congress enact a measure this year to reduce individual and small business income taxes and I would offer as a suggestion the bill, H.R. 10478, which I have introduced to provide for an increase over a 2-year period in the personal income tax exemptions of an individual taxpayer—from \$600 to \$700—and in the surtax exemption of a corporate taxpayer—from \$25,000 to \$29,000. This legislation should be enacted this year and reenacted every 2 years for a total of 12 years to raise the individual exemptions to a total of \$1,200 and the cor-

porate surtax exemption to \$50,000, as is suggested by another bill of mine, H.R. 10477.

This is a modest proposal, but one which I believe in the long run would be of great value to the economy of the Nation. The tax cut would serve two purposes: It would return money to the citizens so they could meet their local needs, such as schools, and it would stimulate the economy. I have noted that the average annual increase to the Federal Treasury since 1945 has been \$2.7 billion. The program outlined above would cost less than \$2 billion annually so in the long run the growth in the economy and consequent increase in tax revenues would help make up the deficit.

Back in 1913 when the first modern Federal income tax was adopted, a married couple with two dependents enjoyed an exemption of \$4,000. Today, the exemption allowed is only \$2,400. In terms of purchasing power, the \$4,000 exemption allowed in 1913 is the equivalent of about \$12,123 today. Of course, I do not say that we should raise exemptions to that level because I realize it would mean too great a loss to the Federal Treasury.

Bringing the comparison more up to date, one would need \$1.67 today to buy what a dollar bought in 1945. In other words, one needs about 60 percent more money today to buy what one could in 1945. And since 1945 the amount of revenue received by the Federal Government from individual and corporate income taxes has almost tripled.

In view of that, I believe some tax relief is called for.

By proposing a tax reduction for individuals and small business, I realize that I am taking the opposite position to the administration. But I feel that because of the high taxes now imposed on our people by the Federal Government, they are becoming less and less willing to accept the responsibility of paying for local obligations, such as schools, essential community facilities, civic improvements, health care for the aged, and so forth, which historically have been the responsibility of the local communities, and of the individual and his family. Because of the Federal tax structure, business, especially small business, finds it difficult to accumulate capital for reinvestment and expansion. Consequently, more and more demands are being made on the Federal Government for assistance in these various areas, and the more demands that are made the more new programs have to be established to furnish the assistance. As the Government expands, it needs more money to operate.

I believe that if the administration feels it can afford to spend several million or billion dollars on various programs, then it can afford to give individuals a cut in taxes and let them use that money back home to pay for their local needs instead of looking to the Federal Government to meet those needs. Unless this is done and the trend continues as it has in the past, the individual will find himself in the same plight as the workers in England who, according to a recent report, are grumbling because taxes

take about 40 percent of their salaries and there is no relief in sight.

You might call this proposal to cut taxes appropriation in reverse. Instead of taking money from the people, deducting from the amount received administrative costs and returning a lesser amount to the people, you let the people have the money to dictate how they want it spent.

If some of them decide to spend it to purchase new cars, new household items, and other hard goods, which I believe many would do, production would be increased and men would be put back to work. We are all very much aware of the unemployment problem in the country. In my own area, for example, employment in one plant dropped from a peak of 23,000 to about 3,700 to 3,900 at the present time. Workers with as high as 27 years of seniority have been unemployed from 18 to 23 months. They cannot find work anywhere and there will not be any jobs unless there is an increase in demand with a consequent increase in production.

If these people are put back to work, the Government, instead of having to pay money out for unemployment compensation, will gain added revenues from payroll taxes, while saving money. In fiscal year 1961 over \$22 million was given to Michigan by the Federal Government for the Temporary Unemployment Compensation Act.

A man on unemployment compensation or one facing the prospects of unemployment is not going to spend his money on major items of production; he is going to conserve it to make sure that he and his family will continue to eat as long as possible.

That might be the solution to the consumer riddle which is puzzling President Kennedy and his advisers according to the following article which recently appeared in the March 25, 1962, issue of the Detroit News:

[From the Detroit News, Mar. 25, 1962]

UNITED STATES TRIES TO PEP UP BUYING—KENNEDY LOOKS TO CONSUMERS FOR LIFT IN BUSINESS

(By Tom Joyce)

WASHINGTON, March 25.—President Kennedy and his economic advisers are trying to solve the "consumer riddle" that is jamming up the gears in the administration's attempt to shift the Nation's economy into high speed.

The experts are frustrated by what appears to be increased reluctance of the consumer to part with his dollars.

Administration sources are convinced that the consumer "is loaded." But so far this year he has not shown any great desire to spend, especially for hard goods.

KENNEDY PLEA

In his economic message last January, Mr. Kennedy outlined what was described as a "bold approach to get the country rolling."

Mr. Kennedy said that while the momentum of the economy had been restored, he wanted the means to "sustain our prosperity and accelerate our growth."

Congress has already responded to part of the President's program by approving his manpower retraining proposal. And there is some chance for favorable action soon on the administration's tax reform bill, intended to provide business with an incentive to invest in new tools of production.

UP TO CONSUMER

In the long run, however, it is the consumer—the buyer of automobiles, televisions and black-eyed peas—who has the economic growth rate throttle in his hands.

And he isn't pushing it forward fast enough to suit economists, who want at least a 4½ percent annual growth rate.

Commerce Department figures show that in the last quarter of 1961 the level of disposable income was at \$375.6 billion, compared to \$354.9 for 1960.

At the same time, savings in 1961 were \$27.1 billion while they were only \$22.7 billion in 1960.

On top of greater savings, borrowing for installment credit is down.

While automobile sales have shown gains after the 1958 recession, the value increase has been slowed by the acceptance of lower-priced compact cars.

SEEK TO CUT IDLE

The administration first is seeking full employment—or what economists call full employment.

In realistic terms, this means bringing the unemployment rate down to 4 percent, which in today's labor force would mean roughly 2.9 million unemployed workers instead of the present 4 million.

To attain this, there must be an improvement in the Nation's economic growth from the present 3½ percent annually.

Price stability and equilibrium in the balance of payments are the other main goals.

To solve the balance-of-payments problem the administration is hoping that Congress will pass the President's proposed trade law that would slash tariffs.

NEED NEW PRODUCTS

But in the final analysis, it is the consumer, not governmental measures, that will determine whether the goals will be attained.

The administration is hoping for a buying spree this spring, especially in the appliance, automobile and housing fields.

A major problem, according to experts who study "the enigma of the consumer" is that there are not enough new products to get people excited about buying.

One of the real hopes for the future is in the fast-growing field of research and development.

Mr. Chairman; there may be some who will say that the Government in these times cannot afford the loss to the Treasury which will result from enactment of a bill such as I am proposing. While there may be some loss at first, I do not believe it will be a total loss for it will be made up in various ways, some of which I have mentioned.

Most of the savings to the individual taxpayers will end up in the form of spending on goods and services. These purchases will stimulate business and will result in increased business profits and increased income to the Treasury from Federal taxes on those profits. In stimulating business, the additional purchases will provide more jobs and help to alleviate unemployment conditions such as exist in my district and other sections of the country and will provide more revenue for the Government from the additional income taxes that will be paid. There will be less demands on the Federal Government and economies can be effected in Government operations.

Business will be encouraged to reinvest money for expansion, which will add to the growth of the economy.

I believe that if we can afford a deficit as is anticipated in H.R. 10650, with the

expectation that it will be eventually recouped through stimulation of the economy, we can afford a deficit by cutting income taxes as I am proposing, with the same expectation.

I urge the House to give serious consideration to this proposal.

Mr. MILLS. Mr. Chairman, I yield 10 minutes to the gentleman from Virginia [Mr. HARRISON].

Mr. HARRISON of Virginia. Mr. Chairman, for months I have listened to the tales of woe and disaster that this bill will bring to the widows of America. The mail that is coming in, obviously inspired, from people whom I suspect are not widows, tries to tell me what this measure will do to the widow's mite. For months in committee we have heard about the effect of withholding on the poor widows. For 2 days here in this debate we have listened to what will happen to the widows, and I have reached the point of such emotional feeling in my bosom that it makes it difficult for me to speak without taking my towel in hand and shedding tears.

Mr. Chairman, the first thing we ought to look at, however, is which widows are we talking about? They are not the old widows, because any widow over 65 is not affected by this bill. So we start out with the proposition that we are dealing with young widows. Then we might also go into inquiring—which widows are we talking of, since we realize that this bill does not cover the widow who earns her living by the sweat of her brow working 8 or 10 or 12 hours a day in a laundry; or in the agricultural areas of our Nation in a processing plant or in the harvest fields. Oh, no, Uncle Sam takes his share of that widow's mite before he lets it get into her hands. Therefore, Mr. Chairman, we are dealing with young widows—and, wealthy young widows. You know it is my sad duty to confess that there was a day in my life that I would have been willing to contribute to the tax bill of wealthy young widows, if it would make them happy. But unfortunately the inexorable march of years has made me such a stranger to those sentiments that I now prefer my own pocketbook to those of rich young widows who are not paying their fair share of taxes by failing to report them.

So when we come to the tragic story of the widow and the orphan let us bear in mind that we are talking about the orphan over the age of 18 and the widow who is younger than 65, and on whose income on top of any earnings she owes taxes she is not reporting.

And we are also including the old women who wear pants and who have bald heads and wear beards, who are not paying their share of taxes. I do not see any reason why I should continue to pay taxes on their income which for one reason or another they are not reporting.

Now, I want to say just a word about the investment tax feature. My friends on the other side have gone full swing on this. American businesses today are fat cats, they say. A previous speaker referred to them as economic royalists, but in committee these gentlemen were

so interested in American business that they offered as a substitute for this provision of the bill the Baker-Herlong bill. With reference to the Baker-Herlong bill, I asked the Secretary of the Treasury one question: What would have been the effect on the revenue this year if that bill had been enacted into law 6 or 7 years ago when it was first proposed by the NAM. And he answered that question by saying it would have produced a deficit in fiscal 1962 of \$23 billion.

Mr. BYRNES of Wisconsin. Mr. Chairman, will the gentleman yield?

Mr. HARRISON of Virginia. I yield.

Mr. BYRNES of Wisconsin. If my memory serves me right that question came from the Democratic side of the committee. The only issue as I understand was whether we were going to table the motion or not table it and give further consideration to various aspects of the Baker-Herlong bill.

Mr. HARRISON of Virginia. The gentleman's memory is precisely correct and there was 1 Democratic vote for it and 10 Republican, those people who now say a bill of \$1,200 million a year is too much to give the economic royalists are the same people who a few weeks ago wanted to give them \$25 billion a year.

Mr. BYRNES of Wisconsin. Mr. Chairman, will the gentleman yield further?

Mr. HARRISON of Virginia. I yield.

Mr. BYRNES of Wisconsin. Was not the issue the question of a motion to lay on the table so we could not consider any of the revisions in the Baker-Herlong proposal? Was not that the issue before us in the committee?

Mr. HARRISON of Virginia. The issue was to take up a bill. There was 1 Democratic vote and 10 Republican votes for it. That was the issue.

Mr. BYRNES of Wisconsin. I want to be fair and I know the gentleman wants to be fair. Was not the issue the question of whether we would table the motion to consider the substitute?

Mr. HARRISON of Virginia. The question was the effort to get it up and out. Then, the gentleman from Wisconsin proposed a bill that would give great aid to these economic royalists. It was an amazing combination of CURTIS IKARD and rapid depreciation and the kitchen sink, and what it would cost nobody knew exactly because everybody knew it was not going to be seriously considered.

Mr. BYRNES of Wisconsin. Was not the effort to get the bill up so we could have fair discussion of it?

Mr. HARRISON of Virginia. On yesterday the distinguished gentleman from Ohio said he did not want an open rule but one under which he could offer that bill to aid these people whom today the Republicans call fat cats and economic royalists. Now they are going to offer a motion to recommit the effect of which my good friend the gentleman from Wisconsin has said will be to give American business no incentive in their competition with foreign business. Yet it is a fact that in every Western nation of the world there is a special tax incentive given by the government of that country for the purpose of enabling

them to compete with American industry.

Mr. BYRNES of Wisconsin. I hope the gentleman will review the surveys that have been made by the Treasury as to what the situation is in these other countries in face of the remark the gentleman has just made, because the gentleman from Missouri analyzed that statement that was made at one time by the Secretary of the Treasury that they had these incentives but if you will look at yesterday's RECORD you will find how wrong that statement is.

Mr. HARRISON of Virginia. The gentleman from Missouri also said in connection with the foreign tax provisions of this bill, "Yankee come home." The position of the gentleman from Missouri and the gentleman from Wisconsin is that the Yankee cannot stay home. They want to make him go abroad. They will give him nothing in the way of a tax incentive if he keeps his plant and whistle blowing here in America. But it is made sacred if he takes his plant abroad.

In connection with the matter of competition, the gentleman from Wisconsin knows that in Belgium there is a special tax reduction equal to 30 percent of the amount of investment in industrial property in actual depreciation.

The gentleman from Wisconsin wants American industry not to compete with that.

American industry is told, in effect: "Go to Belgium if you want to compete with the Belgians; you will get no such consideration here."

In 1961 the Canadian Government introduced an incentive for new capital expenditure in the form of an increase of 50 percent in capital consumption allowances otherwise available. American industry is told: "Go to Canada if you want to compete with the Canadians; you will get no such consideration here."

France permits a variety of special incentive deductions, including two ordinary annual deductions in the first year of the life of the asset and a 10-percent initial allowance. American industry is told: "Go to France if you want to compete with the French; you will get no such consideration here."

Japan permits an initial allowance equal to 33½ percent of the cost of the asset. American industry is told: "Go to Japan if you want to compete with the Japanese; you will get no such consideration here."

The Netherlands provides an equivalent to an investment credit of approximately 10 percent. American industry is told: "Go to the Netherlands if you want to compete with the Dutch; you will get no such consideration here."

The United Kingdom permits the deduction of an initial allowance over and above the first regular depreciation in amounts ranging up to 30 percent of the cost of the asset. In addition, the British have an investment allowance ranging from 10 to 40 percent of the cost of the asset. This investment allowance is deductible in addition to ordinary depreciation and the initial allowance. American industry is told: "Go to Great Britain if

you want to compete with the British; you will get no such consideration here."

Italy provides for depreciation substantially in excess of realistic depreciation as its means of stimulating investment, permitting a reduction from the normally useful depreciable life of as much as 40 percent. American industry is told: "Go to Italy if you want to compete with the Italians; you will get no such consideration here."

The cry is, "Yankee, come home," but the tax incentive to bring him home, or keep him home, is attacked here. The American businessman will read the message as, "Yankee, go abroad, if you are to survive."

For my part, I want to continue to hear the factory whistles blowing in Virginia.

When the sun rose yesterday the gentleman from Wisconsin had a program for American business, but when the sun set last night he had nothing but a motion to strike.

Mr. Chairman, Mr. Emerson said: "Inconsistency is the hobgoblin of little minds." But if this be true, I concede that the Republican membership of the Committee on Ways and Means of the House are the greatest minds in America. As far as I am concerned, the gentleman knows that in offering his motion to recommit it will strike at the very heart of this bill and the reason for its existence, the reason for its being here. None of the rest of the measure will become law in that event. That means that the gentleman is in favor of leaving undisturbed the tax treatment of some of these huge corporations that are masquerading as farm cooperatives. It means leaving undisturbed the complete tax exemption of mutual insurance corporations on their income from underwritings. The gentleman knows it will leave undisturbed the disgraceful tax advantage held by mutual thrift institutions with assets of \$110 billion, which pay no tax, or practically no tax. It means the end of the bill.

Frankly, I am tired of paying other people's taxes. I think the time has come to take a step toward equalization of taxes. My criticism of this bill is that it does not go far enough in discouraging these foreign tax havens, it does not go far enough in correcting tax inequalities. I am perfectly willing to pay my income tax, but I am tired of paying it for other people who have the same income I do and who do not pay their fair share of the taxes.

Mr. KNOX. Mr. Chairman, I yield 5 minutes to the gentleman from Illinois [Mr. ARENDS].

Mr. ARENDS. Mr. Chairman, for over a year the Congress has had under consideration President Kennedy's recommended revisions in our tax laws. This is the second day we have formally debated the committee bill.

I only wish, Mr. Chairman, we would be as careful in considering the spending measures as we are in our consideration of a revenue raising measure. If we were, we would not have to be considering a tax increase bill but rather might be considering a tax relief bill. I am not complaining that we have taken so much

time on this tax bill. I am complaining that we have taken so little time on the spending measures.

Mr. Chairman, I should like to call attention to the dangerous numbers game the President has been playing with the American people for the past 2 months. He is playing this same numbers game with the 1963 budget as he played with the current 1962 budget.

The object of the Kennedy numbers game is to see how large a financial burden the American people will bear. The test of political skill is for the President to announce a number, higher than the previous one, without the American people being aware that it was higher. By quietly announcing increased deficits in the budget the President is hoping the mounting unpaid bills will not be noticed and the American people will not checkmate him in his moves.

As I reconstruct it, this is the way the President played the game with the 1962 budget:

January 16, 1961: President Eisenhower submits a realistic budget for 1962 showing a \$1.5 billion surplus.

February 27, 1961:

President Kennedy has told leading congressional Democrats he is banking on an upturn in the economy to hold next year's budget deficit to \$1.5 billion.—Associated Press.

March 24 and 28, 1961: President Kennedy delivers two budget messages to Congress and now proposes a \$2.8 billion deficit.

May 8, 1961:

Budget director David E. Bell indicated to Congress today that the Federal books were likely to be more out of balance next year than had been officially estimated. Mr. Bell declined to pinpoint the outlook as of now, but there are signs pointing to a deficit at least \$1 billion greater than the figures given by Mr. Kennedy.—New York Times.

May 20, 1961:

Elmer B. Staats, Deputy Director of the Budget, said yesterday that President Kennedy's estimate of a \$2.8 billion Federal 1961-62 deficit is obviously too low. He said that the Government's red ink operations in the next fiscal year probably would be twice this amount, or about \$5.6 billion.—Washington Post.

October 16, 1961: Secretary of the Treasury C. Douglas Dillon announces that the deficit will pass the \$6.75 billion mark.

January 18, 1962: An official forecast puts the deficit at \$7 billion.

That was the way the game was played last year—from \$1.5 billion surplus to \$7 billion deficit in 7 steps.

Now it appears that the game is starting all over again. Just 10 weeks ago the President's budget message to Congress showed a \$500 million surplus. Yesterday, the New York Herald Tribune reports:

The Federal Government will have a sizable budget deficit next year instead of the slender surplus that President Kennedy predicted in January. The best judgment of Government experts is that the fiscal 1963 deficit will total at least \$2 billion and could surge past \$4 billion.

This is distressing news for all Americans. It is also distressing that the

Kennedy administration does not square with the American people, but instead chooses to play this highly irresponsible numbers game.

(Mr. BECKER asked and was given permission to extend his remarks at this point in the RECORD.)

[Mr. BECKER'S remarks will appear hereafter in the Appendix.]

Mr. KNOX. Mr. Chairman, I yield 5 minutes to the gentleman from Indiana [Mr. ADAIR].

Mr. ADAIR. Mr. Chairman, if I could have the attention, please, of the chairman of the committee, I have a somewhat lengthy question which I would like to put to him.

Under section 17 of the bill—page 175—a member patron—and I emphasize the word "member"—may evidence his consent to have his patronage dividends, arising from his business activities, included in his gross income for Federal income tax purposes in either of two forms: First, he may file a written consent to that effect with the cooperative. Second, the member patron is deemed to have given such consent if he becomes a member of the cooperative or if he remains a member thereof after he has notice of a bylaw adopted by the cooperative providing that membership in the cooperative constitutes such consent. An example of such a bylaw appears on page A135 of the committee report.

As the able chairman of the Ways and Means Committee well knows, many cooperatives have heretofore distributed so-called scrip—that is, capital stock, revolving fund certificates, retain certificates, and the like—to their patrons who were entitled to patronage dividends. Presumably many cooperatives will continue to issue such scrip to those of their patrons who have given their consents to have their patronage dividends included in their gross incomes. I am certain that the distinguished gentlemen from Arkansas is also well aware that the terms "sale" and "sell", as defined by section 2(2) of the Securities Act of 1933, mean dispositions of securities which are the result of voluntary acts performed by the recipient of the securities. This rule is predicated upon basic principles of the law of contracts.

My question is this: Am I correct in understanding that it is the intention here that a person, who either merely becomes a member of a cooperative or merely continues his membership therein with knowledge of an outstanding bylaw of the type previously referred to, shall not be deemed to have performed a voluntary act, within the purview of the Securities Act of 1933, in connection with the distribution of such securities of this cooperative as may be issued to him as a consequence of his having evidenced his consent solely by way of the bylaw consent form?

Mr. MILLS. Mr. Chairman, will my friend from Indiana yield?

Mr. ADAIR. I would be delighted to yield to the chairman of the Committee on Ways and Means.

Mr. MILLS. The gentleman is entirely correct in his understanding.

This provision to which the gentleman refers applies only with respect to income tax consequences and does not in any way affect the application of the Securities Act of 1933.

Mr. ADAIR. I thank the gentleman very much.

Mr. Chairman, turning now to another matter, this proposed Revenue Act of 1962—H.R. 10650—contains certain provisions relieving private U.S. investments in the less-developed countries of the world from these punitive new taxes. I note that the new U.S. tax on earnings from new investments is not applicable to so-called less-developed areas of the world.

However, there is one major aspect of the new tax bill which will operate to drain private capital from the less-developed countries. I refer to the so-called gross-up tax, which applies under this bill with especially heavy impact to the less-developed countries. This is for the reason that the gross-up, as pointed out on page 51 of the committee report, has its heaviest impact when the foreign tax rate is one-half of our 52 percent rate, or in that neighborhood. Since income tax rates in the less-developed countries are generally lower than they are in the developed countries, they tend to fall in this area of maximum impact. Therefore, in its practical application, the gross-up amendment would require the U.S. parent corporation to bring home more money from the less-developed countries in order to pay the increased U.S. income tax and still have enough left over to continue regular dividend payments to its U.S. shareholders.

In effect, the gross-up levies a U.S. tax of 52 percent on the amount of tax already paid by the U.S. subsidiary corporation to the host government. In other words, the new tax is a tax upon money which can never be repatriated or brought back to the United States, because it has already been paid to the host government. Obviously, therefore, the parent corporation must bring back additional earnings of the subsidiary with which to discharge this new tax assessment in the United States.

This seems particularly startling in view of the fact it has only been 2 years since the House considered and passed H.R. 5. While this bill never became law, its central purpose was to stimulate investment in Latin America by providing some amelioration of the impact of U.S. taxes in those areas. It is surprising, to say the least, to find the House now proceeding on exactly the opposite course: to soak U.S. business in the less-developed countries with an added U.S. tax.

I suspect your bewilderment will be complete, as is mine, when I remind you that only last year we enacted into the very preface of the foreign aid bill, the Act of International Development of 1961, the policy of "minimizing or eliminating barriers to the flow of private investment capital" to Latin America and other recipients of our foreign aid.

Now, this year, we are asked to enact a tax bill which will have the direct and immediate effect of draining additional

private capital from these needy countries. This violates the aid bill we enacted last year, and can only lead to the demand for increased foreign aid dollars to replace the money which will have to be brought back to pay these additional U.S. income taxes.

(Mr. ADAIR asked and was given permission to revise and extend his remarks.)

Mr. MILLS. Mr. Chairman, I yield 5 minutes to the gentleman from Massachusetts [Mr. BURKE].

Mr. BURKE of Massachusetts. Mr. Chairman, there has been a great deal of detailed discussion on the floor of many aspects of the bill now before the Committee. I am sure it is unnecessary for me to remind my colleagues that in any large tax bill, due to the nature of the subject, it is impossible for everyone to be completely satisfied. Certainly this is true of the bill which has been reported from the Committee on Ways and Means and which is now under consideration here. However, we must be fair-minded and objective and, to the best of our ability, bear in mind the overall public interest, and vote accordingly. On this basis I am constrained to vote in favor of this bill although I must make it quite plain that there are, indeed, provisions of the bill which I think should not be in it, and there are two particular points I want to make.

First, in the Committee on Ways and Means I opposed with all the force that I could command the provision for withholding on interest. In fact, I made several attempts to have the subject of interest separated from the subject of dividends but was unsuccessful. I am strongly opposed to the withholding provision on interest, and I regret that this provision is in the bill.

Second. At the same time, Mr. Chairman, I must make it clear that the principal reason I have supported this bill is the provision in it to stimulate our domestic economy so that we will be in a better competitive position at home and abroad. The investment credit provision is in my judgment necessary and it will help do the job. This is a key provision of the bill and I have strongly supported it from the very beginning. I have been willing to lend my support to the bill because of this provision, even though I oppose other provisions.

In the light of what I have just said, Mr. Chairman, I oppose the motion which will be offered to recommit this bill to strike out the investment credit provision. As they have explained it, their motion will provide for striking both the investment credit and the withholding and for this reason I will vote against the motion. I am doing so because of my strong support for the investment credit provision. It is a key part of the bill. It will help American business compete. If the motion had gone only to the interest area I would have a different position. However, the motion will undertake to strike out the investment credit provision, the very heart of the bill, and the reason why I supported the bill in the first place, and I cannot vote to recommit this bill to

strike out this provision. I therefore oppose the motion to recommit.

Mr. Chairman, the entire Nation, the entire business community of this country, is looking forward to this tax investment credit. This will be a shot in the arm to business in this country. I am surprised to see that there are Members of this House who are opposing these provisions, particularly because this will help small business, businesses which have acquired new machinery. That will help the small businessman in this country. It will help the farmer and the other business people in the Nation. It certainly deserves the support of the entire membership of this House and I certainly hope that the motion to recommit will not prevail.

Mr. KNOX. Mr. Chairman, I yield 5 minutes to the gentleman from New York [Mr. LINDSAY].

(Mr. LINDSAY asked and was given permission to revise and extend his remarks.)

Mr. LINDSAY. Mr. Chairman, I have asked for this time to make some comments on what has happened in this bill. I do so with all due deference to the Committee on Ways and Means, because I know how much time the members of the committee have put into this subject under the leadership of the distinguished chairman of the committee, a man for whom I have the highest regard, and the distinguished ranking minority member of the committee.

I begin by not taking it lightly that, to start out, this bill will create a deficit in fiscal 1963 of \$1 billion; thereafter, \$300 million per year. I do not shy away from Federal spending when I think it is in the best interests of the United States. But also I think that the Congress has an obligation and a duty to have the courage to pay for the programs it enacts. Therefore, I think it is imperative that we not take steps that will reduce Federal revenues. That is point No. 1.

Point No. 2: The devices built into this bill are unmodern. What the majority of the committee has done is to create devices and proposals which are in effect reactionary.

I am glad that the gentleman from Missouri [Mr. CURTIS], pointed out yesterday the inaccuracy of some of the statements that have been made around here on the subject of what the booming countries of Europe have been doing. These countries, with very limited exceptions, and those very narrow and specific, use accelerated, rapid depreciation techniques. Most of them use the double declining balance method. If we, in this country, want to provide a real incentive for economic growth, to stimulate growth, the way to do it is not by this 7-percent credit gadget, which is discriminatory and limiting, but by a method which grants accelerated, rapid depreciation. Contrary to what the gentleman from Massachusetts said a moment ago, this bill does not help small business. It would leave out large segments of the economy and provide a windfall, as has been pointed out, for other segments of the economy. Why on

earth we cannot use the tried technique that modern Europe has discovered the most helpful, is beyond me. I honestly think that what happened to the majority here is that they were sold a bill of goods, which was the idea of, perhaps, one or two men connected with the administration who eventually got their way. I think we are going to live to regret what we do in this bill, if we choose this tax credit, windfall device instead of going the modern way.

Let me talk now for a moment about the taxation of foreign income. One problem in connection with this that has not been sufficiently emphasized is that the bill will abrogate certain treaty obligations that we have. I am referring to that little last section in the bill, section 21, which reads as follows:

Section 7852(d) of the Internal Revenue Code of 1954 (relating to treaty obligations) shall not apply in respect of any amendment made by this act.

Now what this means is that if there is anything in this bill that is in conflict with a convention or treaty to which the United States is a party, the bill will override it. Now how reactionary can you get? The Organization of European Cooperation and Development—OECD—is one of the vehicles in Europe of which the United States is a member, thank Heavens, that is creating one of the most wonderfully exciting economic climates for growth in the world. There is a provision in this convention, which the U.S. Government agreed to, which provides that income which is not paid out shall not be taxed. We here are flying right in the face of that convention to which the United States is a party.

I might point out also that under treaties to which the United States is a party, there are provisions for withholding of taxes on dividends of nonresidents, which is less than the 20 percent which is provided for in the committee bill. This bill will abrogate those treaties.

Mr. Chairman, we in this country must learn how to compete. I wish that the distinguished gentleman from Louisiana, the majority whip, who spoke a little while ago were present on the floor now, as I listened to his remarks with interest and with astonishment, and I would like him to listen to me. He spoke eloquently about the new Europe. And yet he advocated a course of economic isolationism and of sheer reaction. The bill will do exactly the opposite of what he says it will do. From the 7-percent tax credit provisions straight through to the provisions concerning the treatment of foreign income, the bill flies right in the face of and is directly contrary to the efforts we must make in the United States to learn how to compete with Europe and to draw closer to the European Economic Community. We are damaging our position abroad by this bill and retreating to an economic isolationist view that I thought we had long since given up.

Mr. Chairman, it seems to me that if this country is going to learn how to compete in Europe and elsewhere, we should not be shying away from efforts that U.S. businesses wish to make to in-

vest abroad and to explore new markets. I can assure the Members of the House, if these provisions with respect to repatriation of foreign income go through, it will not result in repatriation of profits that are made abroad by U.S. companies. The fact is that these companies want to expand abroad. They want to grow in Europe and elsewhere and to explore new markets. They will repatriate only so much of their profits as is necessary to pay the U.S. tax. And do you know what that will result in? It will result in higher foreign taxes and, consequently, higher credit against that tax and therefore lower tax revenue to the United States.

The balance-of-payments question was mentioned by the distinguished majority whip. I submit that the statement the gentleman made is like something out of the Dark Ages. You do not cure the problem of balance of payments by this kind of retrogressive reactionary taxation. You do it by increasing your exports. You do not increase your exports by discouraging U.S. investments abroad. This is directly contrary to what this Congress must do with reference to liberal reciprocal trade legislation. It is contrary to the growing effort to gradually bring U.S. private free enterprise into the area of foreign aid so that the burdens of the Government are lessened over the years.

I submit that this bill is an unmodern, reactionary retrogressive approach to the modern problems of today. I oppose the 7-percent tax credit provision. I oppose those provisions in the bill that have to do with the taxation of oversea income.

Mr. Chairman, I submit that the motion to recommit should be carried.

Mr. MEADER. Mr. Chairman, will the gentleman yield?

Mr. LINDSAY. For a brief question.

Mr. MEADER. First, I would like to associate myself with the remarks the gentleman has been making. I sought to have the gentleman from Louisiana [Mr. Boggs], when he made his remarks, yield to me, and he refused to do so. I should like to ask the gentleman this question which I would have put to the gentleman from Louisiana. The gentleman from Louisiana talked about our endeavor to compete with the Common Market producers and Japan. Let me ask the gentleman from New York whether or not in his opinion this punitive provision on foreign income would not more effectively freeze out our competition with foreign manufacturers than the tax credit provision?

Mr. LINDSAY. Absolutely. The gentleman is correct.

One final comment, and that is on a matter mentioned by the chairman of the Ways and Means Committee yesterday. He suggested that an official of the Eisenhower administration, the former General Counsel for the Treasury Department who happens to be my brother, made a speech in September of 1960 in which he pointed to the large amount of dividend and interest income tax owed the United States. When we go back into the House I shall ask consent to have the pertinent parts of that speech placed in the CONGRESSIONAL RECORD.

What was said in that speech and what I say here is that in 2 or 3 years this withholding provision will be totally unnecessary. It will be just as archaic as can be because due to modern data processing and new accounting systems being employed by the Internal Revenue Service, all income owed to U.S. Government will be collected. Meanwhile, we know perfectly well that this device is designed to create massive overwithholding, a windfall to the Government of money that does not belong to it and which should be placed into the economic stream of the United States in order to promote economic growth.

I suggest that it is important and necessary in considering this motion to recommit that the Congress remember it is time for our tax structure to be modernized, that it is high time the distinguished members of the Committee on Ways and Means stop tinkering with the tax laws and undertake real tax reform, which we do not have in this bill. This bill if passed in its present form will do nothing but impose a period of economic isolation upon the United States, will not provide the kind of economic incentive that is needed for growth that we must have in this country, and does not face up to the problem that we must face up to most of all, which is how to compete. We shy away from it. It is high time that we started moving forward in this regard instead of backward.

Now, Mr. Chairman, I should like to examine in greater detail the three troublesome provisions in this bill.

In this connection I should like to say that I have had some very expert assistance from distinguished tax authorities in my community. I should like to express my appreciation to them for their contribution toward the improvement of this important piece of legislation.

One of these authorities is my brother, David A. Lindsay, who, as the distinguished chairman of the Ways and Means Committee referred to earlier in the debate, was General Counsel of the Treasury under the Eisenhower administration. His research and contribution in connection with this bill was particularly aimed at the withholding provision. He is opposed to it, as he is to the 7-percent tax credit provision and the provision relating to oversea income. But more of this later.

I should like first, Mr. Chairman, to discuss the 7-percent tax credit provision.

All of us, I believe, recognize the need to encourage business expansion through investment in new machines and facilities, and the desirability of overhauling a tax system which at the present time retards rather than furthers this end.

Most businessmen believe that the best means of reaching this objective is to liberalize the tax law dealing with depreciation by permitting businesses to write off the cost of depreciable property over a shorter, more realistic number of years. Through its current revision of Bulletin F, the Treasury Department is furthering this end but everyone recognizes that administrative measures alone will probably be insufficient to stimu-

late the amount of new investment which is necessary if our economy is to expand to the extent to which it is capable.

Notwithstanding this background, the administration and now the Ways and Means Committee have come up with a new, complicated, and totally untested investment credit plan which is supposed to accomplish this end. Clearly, the burden is on the proponents of this plan to show that it is preferable to faster depreciation.

As I mentioned earlier, rapid depreciation is the modern way to stimulate economic growth. It has been found effective and workable in the booming countries of Europe, most of which use the double declining balance method of depreciation. Incidentally, the statements made by some that European countries use the method of incentive proposed by the majority is simply not true. I was glad that the gentleman from Missouri [Mr. CURTIS] yesterday straightened out the record on this.

Nothing that I have read or heard has convinced me that this credit plan will do a better job than faster depreciation in stimulating the economy. On the contrary, I believe that the tax credit proposal represents an ill-advised device which may not accomplish the desired goals and will introduce additional inequities and loopholes into a tax law already overburdened in that respect.

First, it is the almost unanimous testimony of the business community that the investment credit will not encourage as much new investment as would a liberalized depreciation program. It is those businessmen and not Mr. Surrey's economists who will be making the investment decisions which we are trying to influence. It would be risky to buy such a provision under any circumstances, but it would be senseless to adopt it when it is opposed by the very group it is meant to benefit.

Second, the application of the tax credit will be highly discriminatory, since it will apply only to investments which are made in the future. No tax credit will be available for investments made in the past, even though they have equally served to stimulate our country's economic growth. The result of this legislation will be that those who have already modernized their productive facilities without waiting for a handout from the Government will suffer for their initiative while those who would not modernize without receiving a tax lollypop will be rewarded for their indolence. There is no justification for playing favorites in this manner.

Finally, the investment credit amounts to a giveaway to business. When combined with depreciation, the credit will give a businessman a greater tax benefit than if he had deducted the entire cost of his investment property in the year of acquisition. This is just the same as though the Government actually paid part of the businessman's cost for the property. It is different from depreciation, where a businessman can never recover in deductions more than his purchase price. At a time when

the expenses of the Government are increasing, it makes no sense to subsidize business in this manner.

The accelerated depreciation program which the Republican minority recommends is the modern method. It is the system used by the booming countries of Europe, and found workable. First, it would accomplish the necessary goal of furthering business expansion. Second, it would be nondiscriminatory. Finally, it would permit a taxpayer to recover only the cost of his property and not an amount in excess of his cost. The tax credit proposal should be rejected.

Now I should like to examine in greater detail than I did in my opening remarks the proposed tax treatment of foreign income.

In May of last year, President Kennedy submitted to Congress his tax message containing among other things, proposals to change the existing tax treatment of foreign subsidiaries. In general, the administration proposed that the profits of foreign subsidiaries of U.S. corporations be taxed currently as if distributed to American shareholders. This would be in contrast to present law under which the profits of a foreign subsidiary are not subject to tax until they are repatriated as a dividend.

As I review the events leading up to the reporting of this bill, I find the numerous and diverse administration pronouncements and committee press releases on this subject confusing and disheartening. The apparent lack of confidence in what should be done in the foreign areas by the proponents of legislation certainly does not give one the confidence that the hastily contrived provisions in the present bill represent a proper step for Congress to take at this time. Indeed, there is every indication that the bill may seriously interfere with the ability of American business to compete abroad and to retain and build foreign markets.

Before commenting on the bill, I think it might be well to be sure we all understand the provisions of existing law as well as their origin and purpose. It has become popular to refer to the tax treatment of foreign subsidiaries as a form of so-called tax deferral. The administration has referred to this tax deferral as a special incentive feature of our tax laws which favors foreign investments. Our tax jurisdiction over a corporation is determined on the basis of whether it is considered a domestic or a foreign corporation. A domestic corporation is taxable with respect to its worldwide income, while a foreign corporation is taxable only on its U.S. income. The present tax laws define a domestic corporation as one created or organized in the United States or under the laws of the United States or of any State or territory. A foreign corporation is defined by the law as one which is not domestic. Thus, the test of foreignness is based upon the place of incorporation regardless of the nationality of the stockholders. This definition of jurisdiction has been in our tax laws since 1913.

To the extent that shareholders of a foreign corporation are U.S. taxpayers,

the U.S. tax on their share of the corporate profits is deferred until distributed as a dividend. This so-called deferral of tax results from the recognition under our tax laws that a corporation and its shareholders are separate taxable entities. This latter principle applies equally to domestic and foreign corporations.

Thus, it is these two principles—namely, the limitation of our tax jurisdiction over foreign corporations and the recognition of separate corporate entities—which are presently under attack. Neither of these principles was intended by Congress to extend special tax advantages to foreign investment. They are instead, basic and proven durable parts of the structure of our present income tax system.

In the foreign area, H.R. 10650 incorporates substantially the administration's proposals. Briefly the provisions which affect the tax treatment of foreign subsidiaries are as follows:

Certain types of income of a foreign subsidiary would be taxed to domestic shareholders with a 10 percent or greater stock interest even though the profits of the foreign corporation are not distributed. In general, this income would be taxed to the shareholders as if it had been distributed by the subsidiary as a dividend. For this purpose a subsidiary is defined as any foreign corporation in which Americans have at least a 51 percent stock interest. The 51 percent test is met where the requisite stock interest is either direct or indirect, and in the latter connection, the bill contains complex rules for determining indirect stock ownership.

Foreign subsidiary income which is taxed to shareholders under the bill is divided into two categories. First, the bill lists the following specific types of income which are subject to tax:

First. Income from insurance and reinsurance of U.S. risks.

Second. Income from patents, copyrights, royalties and similar property, developed in the United States or acquired from an American shareholder. In addition to the royalties received from patent licenses and the gains from the sale of patents, this type of income would also include income from the use or exploitation of a patent or similar property. Thus, profits of a manufacturing subsidiary would be included and subjected to U.S. tax to the extent that they are attributable to the use of a patent.

Third. Personal holding company-type income such as, interest, dividends, rents, royalties, and so forth, with the important addition of so-called sales income. For this purpose, income from the purchase and sale of property is treated as sales income if it has the following characteristics: First, the property is purchased from or sold to a related company; second, the property is manufactured outside the subsidiary's country of incorporation; third, the property sold is destined for markets outside the country of incorporation; and, fourth, the amount of income thus earned exceeds 20 percent of the subsidiary's income, other than personal holding company income.

For purposes of applying U.S. tax to this type of income, the definition of a foreign subsidiary is modified to require that the 51 percent or greater stock interest be held by five or fewer American shareholders. If more than 20 percent and less than 80 percent of the subsidiary's income consists of personal holding company type income, including sales income, only that portion will be taxable to the U.S. shareholders. But if this type of income represents more than 80 percent of the corporate profits, then the entire income of the corporation will be subject to U.S. tax. The application of the tax to this type of income may be avoided to the extent that it is reinvested in a less developed country operation.

A second category of income which is made subject to U.S. tax by the bill is that portion of a foreign subsidiary's profits which is not invested in certain specific forms of permissible investments. This rule applies to the foreign subsidiary's entire foreign income regardless of its character. The types of investment which are permissible and which prevent the application of U.S. tax are:

First. Property which is located outside the United States and is used in connection with the subsidiary's existing business.

Second. Property in a business—whether existing or new—in a less-developed country.

Third. A 10-percent or greater stock interest in a foreign corporation which is engaged in business in a less-developed country. This type of investment is permitted only where four or fewer shareholders have a 51-percent or greater stock interest in the less-developed country corporation.

Another provision applicable to foreign subsidiary operations relates to the tax treatment of redemptions or liquidations of stock in a controlled foreign corporation. Under the bill gain from such transactions would be treated as a dividend and taxable to American shareholders as ordinary income to the extent of their share of profits. Similar treatment would be applicable to the gain realized by an American shareholder from the sale of such stock. The effect of these rules would be limited to shareholders with a 10-percent or greater stock interest.

These are the principal provisions which would make basic changes in the tax treatment of foreign subsidiaries. They would become effective for taxable years beginning after December 31, 1962.

These provisions of the bill should be analyzed in the light of the several policy objectives which have been suggested by the administration, and which, presumably, are the basis upon which the committee has approved the bill. As I understand it, this legislation is intended to accomplish three objectives: First, it would tend to improve the U.S. international balance-of-payments position; second, it would achieve a greater degree of so-called tax neutrality in the treatment of domestic and foreign income; and third, it would remove the opportu-

nity for abuses of the U.S. tax system which are available under existing law. There is grave doubt in my mind whether the present bill will be useful in accomplishing any one of these objectives.

BALANCE OF PAYMENTS

In considering the desirability or efficacy of the proposed tax measures in improving the balance-of-payments position in the United States, we should first determine the scope and nature of the immediate problem. For the past 3 years the United States has had an overall balance-of-payments deficit ranging between \$3.5 billion and \$4 billion. This deficit takes into account all forms of our international payments and would include, in addition to private investment, such items as military expenditures overseas, as well as such large nonrecurring transactions as the purchase by Ford Motor Co. of British interests. The Department of Commerce figures for the period from 1958 through 1960 show that income returning to the United States from direct private foreign investments far exceeds capital outflows of direct private foreign investment during this period. These figures also show that this excess of return over capital investment is increasing each year. In other words, foreign investment is making an increasingly large contribution to the improvement of our balance-of-payments situation.

The causes of the deficit are not easily isolated. Indeed, it may be attributable to different items in different years. For example, in 1960 a large portion of the deficit was attributed to the outflow of so-called hot money. This outflow, accountable for \$1.5 and \$3 billion in 1960, is partly due to adjustments in foreign interest rates on the one hand, and short-term gold speculation on the other. In either case, the problem was of a short-term nature. Changes in our income tax laws would hardly be the way to handle these problems. The reason that such short-term problems become critical is that we do not have an adequate margin in our balance of payments at the present time. The most obvious way of alleviating the deficit is to build up our existing trade surplus, that is, increase our exports. Another possibility is to prevail upon the advanced European economies to carry a greater share of overseas aid. Both these approaches should be developed by the present administration.

Changes in our tax laws which would discourage foreign investment could hardly be consistent with a long-range policy, since it is these investments which will ultimately build a strong return flow of income to the United States and strengthen our balance of payments situation for the future.

It is unlikely that the proposed changes in the tax law would, in fact, be effective in increasing the return of dollars to the United States on a short- or long-term basis. To the extent that this is an objective, it is based on the erroneous assumption that the primary basis for retaining income abroad, whether it be derived in the form of royalties, interest, dividends, and so forth, is an overall tax

advantage. It is extremely doubtful whether significant amounts are retained abroad for tax reasons. Profits are retained abroad to expand the capital of existing business operations or to provide funds for new investment opportunities. Thus if income which is not subject to tax under existing law is made subject to tax by the bill, it is likely that only the amount needed to pay the U.S. tax will be repatriated. Even this may come from the profits of the domestic corporation rather than from repatriated profits. Thus, the bill may accomplish very little in improving our balance of payments situation. Indeed, one effect may be to encourage European countries to collect more tax, consequently increasing the foreign tax credit and reducing the net U.S. tax.

I think there may be another misconception underlying the provisions of the bill. I have gotten the impression that the administration in advancing its tax program in this area, has assumed that American production presently based abroad can compete for the same markets by producing in the United States and exporting. This assumption ignores the realities of present-day international competition. There are American businesses which have been forced to move production abroad in order to retain foreign markets. That someone is going to produce abroad is a reality that cannot be avoided. If American business cannot compete by U.S. production, it must go abroad if foreign markets are to be retained and built. U.S. business no longer has a monopoly in the world of finished manufactured goods. While the present bill does not propose to tax production income as did the original tax message, it does propose to tax income from activities incidental to such foreign production and to this extent, may cut down the rate of growth of American-owned foreign production, vis-a-vis, our competitors abroad. In the long run, therefore, these tax provisions will tend to cut down on the return flow of income to the United States.

TAX NEUTRALITY

The administration has also advanced in support of its proposals in the foreign area, the need to revise the tax treatment of foreign income to achieve a greater equality between tax burdens on foreign income and tax burdens on domestic income. The assumption that neutrality or equality in tax burden should be measured by the U.S. tax system is unwarranted. The form and direction of neutrality in the bill may create discrimination against our own taxpayers.

The bill provides that an American parent corporation will be taxable with respect to its foreign subsidiary's income from patents, copyrights, secret processes, and the like, which were acquired from the domestic corporation or developed in the United States. While this provision appears to deal with a situation described by the Treasury Department as a so-called tax haven abuse, it extends beyond this purpose by imposing a U.S. tax on a portion of the profits of almost every operating foreign subsidiary

controlled by American shareholders. For example, when a foreign manufacturing subsidiary sells its product abroad, a portion of its profit will in many cases be attributable to the use of patents, processes, and similar property acquired from the parent corporation. To the extent that the subsidiary's profit may be so characterized, it would be subject to U.S. tax under the bill. Parenthetically, it is appropriate to indicate at this point that there is a constitutional question as to the validity of a tax on shareholders with respect to corporate profits. This royalty provision, however, goes even further. It apparently would impose a U.S. tax at the shareholder's level even where the subsidiary had no income, that is, a royalty income would be imputed to the subsidiary even where it had none. This provision is nothing more than an indirect method of getting at the profit of manufacturing subsidiaries. It approaches the original proposal in the President's tax message which would have eliminated the deferral of U.S. tax entirely in the case of subsidiaries in developed countries. It is interesting to note that the present bill goes even further than the President's tax message in imposing tax on royalty income of subsidiaries in underdeveloped countries.

In other respects, the provisions of the bill deal primarily with problems characterized by the Treasury as tax haven abuses. Let me illustrate. The provisions of the bill would tax on a current basis the profits of a Belgian, German, or Swiss subsidiary which sells products manufactured in France by a French subsidiary. Very often this takes the form of a chain of corporations with the American parent company at the top, the Swiss subsidiary in the middle, with the production corporation formed as a subsidiary of the Belgian, German, or Swiss companies. The production company sells its output through its Belgian, German, or Swiss parent company which may coordinate the entire foreign sales effort of a complex of producing companies. Under present law, the income of neither the production company nor the Belgian selling company is subject to U.S. tax, until such time as the earnings are distributed to the American parent. The income of the French subsidiary is, of course, subject to a French tax at the rate of 50 percent. The proposal would tax the income of the Belgian selling subsidiary currently unless reinvested in operations in less developed countries. This means that the American-owned foreign producer would be faced with the alternative of paying the tax on this income or placing the funds in what may be a risky venture in a less developed country, thus depriving its European facility of expansion capital. In order to compete effectively with foreign producers it is likely that the taxpayer will, in most cases, elect to pay the tax, while the foreign-owned producer will continue to defer its national tax on the profits realized by its Swiss selling company.

By imposing tax on these operations, it cannot be expected that they will be removed from Europe and conducted in

the United States. If they are moved anywhere, it is most likely they will be conducted in the country where the production takes place. In this way the overall tax burden of the American-owned foreign enterprises will be increased and our own ultimate tax reduced as a result of the increased foreign tax credit. This form of tax neutrality makes little sense. Instead our objective should be to assure that American-owned business based abroad be given maximum tax equality with its foreign competitors.

It is a well known fact that most of the European countries permit local enterprises to utilize the financial and other facilities available in Switzerland to the same extent as the United States does today. It would seem to be an unwise policy to unilaterally adopt tax measures which would require basic changes in American-owned operations abroad, while our foreign competitors continue to enjoy the status quo.

The idea that a dollar earned by American business abroad should bear the same income tax burden as a dollar earned in the United States assumes that the foreign tax credit granted under our law adequately compensates for imposition of foreign taxes. However, this is only true where the taxing jurisdictions have comparable tax systems. A credit for foreign income taxes is wholly inadequate where turnover taxes and miscellaneous excise taxes account for most of the national revenue of the foreign taxing jurisdiction. Subjecting income to tax in the United States would result in double taxation rather than tax equality.

The provision which imposes tax on a foreign subsidiary's profits which are not invested in certain forms of permissible property may be characterized as the allowance of a special deduction from taxable income for certain types of preferred investments. Application of U.S. tax under this provision may be prevented by reinvesting profits in the subsidiary's existing business, but profits used to start a new business would be subject to tax. Tax could also be avoided by investing in a less developed country operation. These distinctions lack a sound basis in tax policy. If the impact of foreign competition forces the subsidiary into other fields, the same tax treatment should apply in this situation as is applicable when the subsidiary expands existing plant facilities to meet the increased output or greater productivity of its foreign competitors. In his balance-of-payments message to Congress last year, President Kennedy assured us that he did not intend to propose tax rules which would penalize legitimate investment abroad. The term "legitimate investment" is his, not mine. I cannot understand why an investment in a new business—whatever that may be—is any less legitimate than the expansion of an existing one.

In regard to the deduction allowed for profits invested in less developed countries, I can appreciate the administration's recognition of the need to continue the application of tax deferral in these cases. For obvious reasons, we

should encourage the flow of private capital to these areas. However, this principle applies equally to profits earned in the United States. The basis of the bill's attack on American-owned foreign subsidiaries is that their profits should be subject to the same tax burden as are domestic corporations. Once this is achieved through elimination of tax deferral, uniform tax rules should apply. If we are encouraging foreign subsidiaries to invest in less developed countries, domestic corporations should receive the same encouragement. In withholding the tax deduction for these investments from domestic corporations, the bill is applying a double standard. To this extent it may well have a reverse effect; that is, it may encourage American business to establish production facilities abroad to obtain benefits not otherwise available. Indeed, serious consideration should be given to the possibility that the net effect of narrowing tax deferral generally will create a greater incentive for American business to take advantage of the remaining areas of deferral by moving production abroad.

TAX AVOIDANCE

The third objective advanced by the administration in support of its tax proposal in the foreign area is that there is a need for corrective legislation to deal with the so-called "tax haven" abuses. There are two features of our present tax law which encourage this form of tax avoidance. First, as I have already indicated, our income tax does not extend to the foreign income of a foreign corporation. It becomes important, therefore, to define for this purpose the source of the corporation's income. The tax law has long contained source rules. For example, the source of income derived from the purchase and sale of property, that is, export income, is derived from the country in which title to the property passes to the purchaser. The source rules also provide that royalties from patents and other similar rights have a source in the country in which the patent is used. The source of dividend income is in the country where the payer is incorporated and the source of interest is in the country where the debtor resides.

A domestic corporation receiving income in these forms would, of course, be subject to tax regardless of the source. However, if the domestic corporation creates a foreign corporation and places in that foreign corporation the right to receive items of foreign income, the U.S. income tax is postponed until the foreign corporation distributes its income in the form of a dividend to the U.S. corporation.

Tax avoidance in this area should be defined rather precisely because there are many misconceptions about it. First, there are cases in which taxpayers selling abroad can and do avoid U.S. tax by abusing existing source rules. Most of this type of avoidance occurs in the area of intercompany pricing. The term "tax avoidance" has also been used to describe the completely legitimate methods used by large publicly held American corporations with foreign operations to minimize U.S. taxes.

Let me illustrate. A domestic manufacturing corporation sells part of its output abroad. Instead of selling directly to customers or to independent brokers, it sells to its own foreign subsidiary at cost plus a 5 percent markup. Any further profit realized by the foreign subsidiary would not be subject to U.S. tax until distributed to the parent as a dividend. If arms-length prices of comparable products are cost plus 20 percent, then there is clearly a distortion of the domestic corporation's income. But if the 20 percent profit margin is reflected in the intercompany price and the subsidiary on sales to third parties realizes an additional 20 percent profit, there has been no distortion or tax avoidance. Nevertheless, the bill would impose U.S. tax on the subsidiary's profits in either case.

To the extent that this is a problem, the Treasury Department has adequate tools under existing law. Artificial intercompany pricing arrangements may be attacked under section 482 of the Internal Revenue Code. In this connection it is noteworthy that the bill contains special provisions amending section 482 to assure that a proper allocation of income is reached in these cases. Why then does the bill impose U.S. tax on the sales income which is allocated to the foreign subsidiary under section 482, as amended, since by definition the intercompany prices thus determined are proper? There is such a disparity between the corrective measure and the abuse that it is difficult to tell precisely what lies behind this provision of the bill.

Tax avoidance has also been used to describe the organization of an American-owned foreign corporation in such a manner as to minimize foreign taxes.

Thus, an American corporation with a manufacturing subsidiary in Germany may be taxable by the United States on export profits even though no part of the operation has any connection with the United States other than ownership. This may be illustrated by the chain of corporations I have already described, that is, an American corporation with a Belgian, German, or Swiss, or some other subsidiary through which its foreign operations are coordinated.

It is not clear why the United States has an interest in the extent to which an American-owned foreign subsidiary competing with European-owned companies minimizes foreign taxes. Indeed, the reduction of foreign taxes reduces the foreign tax credit and will increase the ultimate U.S. tax imposed at the time of repatriation. The present system enhances the possibility of increased revenues. In any event, the answer to this problem does not lie in imposing unilateral penalties on the current profits of foreign-based American-owned business operations. This is an international problem which should be resolved on a multilateral basis.

As already indicated, the bill would also impose a tax on profits of a foreign subsidiary which are not invested in certain specific types of permissible property. This provision is in the nature of

a tax on accumulated profits. A possible basis for the provision is that amounts are now being held abroad simply for the purpose of avoiding the current imposition of U.S. tax. While there may be isolated instances of this, it is unlikely that the intensity of foreign competition would permit large accumulations of idle capital abroad. Here again, there seems to be little relation between the abuse and the sanction.

Drastic changes in existing tax treatment of foreign income are premature. Even if changes were limited, as the present bill is not, to problems of avoidance of U.S. tax, information as to the extent of this form of tax avoidance is wholly inadequate. For example, prior to 1960 the Internal Revenue Code required information to be filed as to each creation of a new foreign corporation. However, because of a defect in the law, few returns were received. This defect was corrected in 1960. The inadequacy of this type of information was illustrated in one of the documents supporting the President's tax message in which it was admitted that the only information available on the number of American-owned Swiss corporations was obtained through the consulate general in Zurich.

In 1960 the code was also amended to require domestic corporations to file annual information returns covering the activities of their foreign subsidiaries. The first returns under this amendment will be filed this year. It seems to me that Congress would be acting prematurely if it approved any legislation in this field at the present time before this new information is received and analyzed.

I would like to call your attention to an effect this bill will have which has received little notice but is what I regard to be an unprecedented and unwise action on the part of Congress. Because of certain changes that the bill makes to existing law, it will result in abrogating certain treaties. To the extent that the bill's provisions are inconsistent with a treaty obligation of the United States, the law will prevail and the treaty obligation will be abrogated. The reason for the provision—and I am referring to section 21—is that a number of the provisions in the bill are in conflict with income tax conventions we have negotiated with European countries. I question the wisdom of abrogating by legislation our treaty obligations even in the technical field of international taxation, particularly, when we are approaching a time of negotiation in trade and other economic matters with the Common Market countries. It seems to me that the problem of so-called tax havens is a proper subject for multilateral discussion with Europe and may even be susceptible to solution through international agreements. With these discussions forthcoming, and the U.S. position in world competition rather precarious, I cannot think of a more inappropriate time than the present to enact hastily prepared legislation which would change longstanding rules for the taxation of American business abroad.

Lastly, Mr. Chairman, let us examine in greater detail the withholding proposal. I am opposed to it and do not think that the majority has made out a case for it.

I share the concern of the Treasury and the committee about the failure of some taxpayers to report fully and properly all of their income on which tax is owed. All of us, I am sure, would want to support any plan that would improve the reporting of income, provided of course the gain to be derived from any plan exceeds the costs of administration, and provided the plan is fair.

Withholding on wages has served us well. The proposed plan to withhold 20 percent of tax on interest and dividends, however, bears little or no relationship to our system of withholding on wages. In point of fact, it would be extremely expensive and perhaps impossible to equate interest and dividend withholding with wage withholding.

Wage withholding is coupled with safeguards—safeguards for the taxpayer and safeguards for the Government. In wage withholding, overwithholding is effectively kept to a minimum—and almost eliminated. The 18-percent rate has built into it the standard deduction. Each wage earner may use his personal exemption, including all his exemptions for dependents, in fixing the amount of withholding. An information return, form W-2, tells him the gross amount to report, and the amount of the tax withheld to credit. The W-2 form also provides an immediate check to the district director, who must compute prompt refunds where necessary. No such system is proposed or is apparently now in the cards for dividend and interest withholding.

The bill would impose withholding on interest and dividends at a flat 20 percent rate without adjustments for personal exemptions and without accompanying W-2 type receipts to assist taxpayers and the Treasury. At the last minute, the committee amended the bill to permit exemption certificates, but as hastily drafted, the provisions for exemption certificates add more confusion than equity to the withholding proposals.

Exemption certificates are in no event permitted for interest on marketable securities. Apparently exemption certificates are permitted for some individuals but not exempt organizations—in the case of dividend income.

In the case of individuals, the paying agents are supposed to keep track of the ages of exempt persons under age 18. An individual over age 17 must file an exemption certificate annually—if, subject to severe penalty for error, "he reasonably believes that he will not"—after application of certain credits—"be liable for payment of any tax."

In the usual situation, where securities are held in the name of brokers or nominees, the use of exemption certificates is left to the discretion of the Secretary or his delegate.

Many nonresident aliens are now subject to withholding at less than the proposed 20 percent rate by treaties. We are now asked to abrogate these

solemn international compacts by voting a provision to the effect that in the case of interest and dividend withholding, the tax "required to be deducted and withheld shall not by reason of the provisions of any treaty be less than 20 percent of such amounts." So much for the good faith of the United States of America under this proposal that the majority is now making.

Much emphasis is placed on the quick refund procedure—proposed quarterly refunds for overwithholding. Qualification for quarterly refunds, however, is complicated, confusing, and extremely limited. The amount of refunds may allowance is 22 percent of, first, an individual's refund allowance. The refund allowance is 22 percent of, first, an individual's expected deductions for personal exemptions, plus, second, his retirement income, less, third, any income which is not subject to withholding for dividends and interest. No claim for refund may be filed by an individual whose gross income is expected to exceed \$5,000, or a married individual whose income of himself and his spouse is expected to exceed \$10,000 or a head of a household or surviving spouse who expects his gross income to exceed \$10,000, or by a child, unless he expects that his parents will not be allowed an exemption for him for the taxable year.

Even with these limitations, the Internal Revenue Service will be flooded with refund claims, and refunds will have to be paid on faith. It will be absolutely impossible to handle prompt refunds and check the propriety of the refund claims.

It should be observed that in the wage field, many persons would not have the money to pay the tax if the tax is not withheld. In the case of dividends and interest the reporting problem seems greater than the paying problem, and the major problem of reporting is not solved by the bill before us. What is needed is information.

Substantial funds have been appropriated for the much celebrated electronic or automatic data processing program for the Internal Revenue Service. To make this program work, the Congress, at the request of the administration, has passed a law requiring the use of numbers on tax returns and information returns. The combination of information returns with a numbered account for each taxpayer, with full use of automatic data processing, is now promised. Clearly, if automatic data processing will be as effective as promised by its proponents in the Internal Revenue Service, withholding on dividends and interest soon will be outmoded or, if needed, will at least be workable. Until automatic data processing is in full swing, or a more workable and fair method of withholding is devised, we should not adopt the stopgap, crude, unfair method of withholding of the kind presented to us in this bill.

Much of my research on the subject of withholding has been provided by the former General Counsel of the Treasury Department, Mr. David A. Lindsay. Yesterday, it will be recalled, the chairman of the Ways and Means Committee

referred to a speech made by Mr. Lindsay, who is my brother, in September 1960 in which reference was made to the amount of uncollected taxes represented in dividends and interest. The implication was clear, unfortunately, that Mr. Lindsay favored withholding. Quite the contrary, he opposes it; and in his speech he points out that modern data processing will make withholding archaic and that it will result in unfair, massive overwithholding. When the Committee rises and we go back into the House, I intend to ask unanimous consent to have the pertinent parts of Mr. Lindsay's speech inserted at this point in the RECORD:

REMARKS BY DAVID A. LINDSAY, GENERAL COUNSEL, U.S. TREASURY DEPARTMENT, BEFORE THE TAX INSTITUTE SYMPOSIUM, CHICAGO, ILL., SEPTEMBER 29, 1960

A subject of interest to the Treasury and management alike is the gap in reporting certain income and possible measures that might be taken to close the gap. While the problem is not limited to dividends and interest, particular attention has been given to those items in recent years. Recent studies have indicated a gap in the amount of dividends paid to individuals and the amount of the dividends reported on individual tax returns of approximately \$1 billion, or failure to report about 10 percent of the total amount of dividends received.

It should be noted that a portion of unreported dividends would not have been taxable since the total includes amounts received by individuals required to file but not subject to tax and by individuals entitled to an offset as a result of the \$50 dividend exclusion.

It was also estimated that about \$3 billion of interest, which is about one-half of the interest received by individuals, was not reported. Here again, a portion of the unreported interest would not have been taxable.

In the last session of Congress, the Senate Finance Committee instructed the staff of the Joint Committee on Internal Revenue Taxation, in cooperation with the Treasury, to study the possibility of instituting a withholding system. While the Treasury's own studies on withholding have covered broader areas than dividends and interest, the Senate Finance Committee and the Joint Committee staff have focused attention on dividends and interest, and more particularly on dividends. As a result of joint studies to date, it appears that it would be extremely difficult, if not impractical, to institute an adequate withholding system for interest payments at this time.

While the mechanics of withholding are less difficult in the case of dividends, here, too, there are a number of difficult problems.

From the standpoint of the Internal Revenue Service, a withholding system on dividends and interest would appear to require dividend and interest payers to furnish a form or forms similar to the W-2 form used with wages. Such a form would show the taxpayer the net dividend or dividends he received, the tax withheld, which he should take as a tax credit, and the gross dividend to be reported in his return. The form would be attached to the return. It would be used to support and to speed refunds in the many instances of overwithholding due to withholding in the case of tax-exempt institutions and nontaxable individuals and overwithholding in the case of elderly and retired persons, many of whom would be in low-income brackets.

With exceptions, it would be simpler from the standpoint of management to handle withholding without issuing a W-2-type form to the taxpayer.

The largest gap in interest and dividend reporting comes from the cumulative effect of many failures to report small amounts. Particularly with respect to interest, we are dealing with a myriad of small holdings and small accounts. Moreover, in many instances there are interposed between the payer and the recipient a number of levels or tiers, such as transfer agents, nominees, and fiduciaries. In addition, there is a large turnover in shareholder accounts.

If across-the-board withholding is instituted without the necessity of payers furnishing statements on W-2-type forms to taxpayers, the Treasury might be faced with a problem as, or possibly more, serious than the present gap in reporting. The Internal Revenue Service would be pressured to make refunds promptly, as it does in the case of overwithheld wages, but without the benefit of a simple check against the taxpayer's copy of the withholding form, and without time to make an audit of the claimant's tax return.

Ultimately, through the development and utilization of electronic data processing machines, referred to as our automatic data processing program, it is possible that withholding on dividends, interest, and other items as well, will become unnecessary or, if considered advisable, will be more practical than it is at the present time. To achieve optimum utilization of electronic data processing machines, it will be necessary to introduce a permanent taxpayer account numbering system, primarily based on social security numbers. A taxpayer account numbering system would be helpful even without automatic data processing as it would clearly facilitate matching of returns. Names appear in a variety of ways, and addresses vary. Numbers can be compared with exactitude. Also, to achieve optimum results, it is necessary to increase our efforts toward coordinated planning among Federal and State tax collecting agencies and management.

Not only the Internal Revenue Service but also several of the large corporations which disburse their own dividends, and many of the disbursing agents, primarily banks and trust companies, have on order, or plan to order, expensive machinery, some of which could dovetail with the Federal program and some of which might not. In planning for the future use of such machines, it is essential that mutual problems and needs are understood in the hope that the planning can be coordinated intelligently.

In the meantime, every effort should be made to improve reporting of dividends and interest as well as other forms of income within the framework of existing law. It appears that much of the gap in reporting is due to negligence, but some of the failure to report is willful.

Last year the Treasury called upon many groups active in the dividend and interest field to cooperate in an information program designed to obtain more complete reporting of dividend and interest income. The program resulted in more than 75 million special notices being mailed to recipients of dividends and interest. This distribution was supplemented by a coordinated information campaign using newspapers, magazines, radio, and television. National associations notified their State and local members in writing and orally, urging full cooperation. Posters were prepared and distributed. In some areas there was joint sponsorship of newspaper items on the subject. Excellent cooperation was given by tens of thousands of corporations, banks, and individuals.

Only about 5 months have elapsed since the filing date for the returns covering the year 1959, and therefore it is too early to appraise fully the extent of increased reporting of dividends and interest. Nevertheless, we do have indications of the program's success from District Directors' offices, from ex-

aminations of selected tax returns before and after the program was instituted, and from the increase in receipts from individuals on nonwithheld income. Larger surveys are underway and should be completed by the end of the year. These should provide further information on the effectiveness of the program.

As indicated earlier, some of the failure to report is willful. The Department of Justice readily agreed to cooperate with the Service in a vigorous enforcement program. Special attention has been given to cases involving the failure fully to report dividends and interest. More than 300 such cases are now in various stages of investigation or prosecution. Thirty-one convictions have been obtained resulting in the imposition of fines ranging up to \$20,000, and in some cases imprisonment.

It is expected that the matter of withholding will be considered by the 87th Congress and that advantages and disadvantages of withholding will be weighed against the results of the program which I have just described.

I shall not venture a prediction concerning either future congressional action in this area or the possibility that immediate solutions to problems presently inherent in withholding will be found. I do suggest, however, that legislation for the sake of legislation, legislation that ignores the major area of gap by focusing only on dividends or by setting a ceiling under which amounts distributed would not be subject to withholding, would be ineffective for purposes of closing the gap.

Mr. MILLS. Mr. Chairman, I yield such time as he may desire to the gentleman from Texas [Mr. THOMPSON].

(Mr. THOMPSON of Texas asked and was given permission to revise and extend his remarks.)

Mr. THOMPSON of Texas. Mr. Chairman, I shall vote for the bill and against the motion to recommit.

Mr. Chairman, one of the constructive features of the bill now before us is the encouragement and financial assistance it gives farmers who wish to modernize equipment and increase efficiency of their crop and livestock production operations.

The significant provision in relationship to agriculture is the allowance of a 7 percent tax credit for investment in equipment and machinery.

The growing importance of mechanization to American agriculture is illustrated by the fact that as of today the investment in machinery and motor vehicles on farms is nearly \$16 billion.

Farmers annually spend over \$2.5 billion for machinery and motor vehicles.

The rapid expansion in mechanization of farm operations began back in the 1940's when wartime labor shortages and favorable prices encouraged a substitution of machinery for hand labor. More recently the cost-price squeeze has caused farmers to continue investing in machinery and equipment to achieve lower unit costs that will maintain, and even increase, incomes.

In the Corn Belt, farmers producing 10,000 to 14,000 bushels of corn can reduce harvesting and storing costs from 10 to 15 percent through use of mechanical picker-sheller and mechanical drying equipment.

Mechanical cherry pickers and associated equipment reduce harvesting costs in Michigan about \$35 per ton.

On medium and large clay-soil cotton farms in the Mississippi Delta, advanced technology including mechanical harvesting would increase returns to land and management several fold compared with current practices. Similar comparisons indicate more than a doubling of returns on deep, moderately sloping land in southwest Oklahoma.

Even in livestock production the shift from a low to a high level of technology will increase the income one man can earn by 70 to 80 percent in poultry, hog, and dairy enterprises. Improved technology in livestock production requires increased investments in buildings as well as in machinery and equipment, but it is clear that increased mechanization is a must for both the livestock and the crop farmer.

Under the bill the tax savings resulting from investment credit on a \$5,000 tractor would be \$350, reducing the farmer-buyer's net outlay to \$4,650.

Other tax savings range from \$217 on irrigation equipment to more than \$2,000 on a large, caterpillar type tractor.

Tax savings resulting from the investment credit on purchases of a typical list of farm equipment items follow:

Item	Approximate cost	Reduction in cost through tax savings from 7-percent credit	Net cost after 7-percent credit
Cottonpicker, self-propelled, 2-row.....	\$17,000	\$1,190	\$15,810
Tractor, 50-59 horsepower.....	5,000	350	4,650
Large caterpillar-type tractor.....	30,000	2,100	27,900
Self-propelled combine, 18-foot.....	8,500	595	7,905
Rice self-propelled combine, 18-foot.....	10,000	700	9,300
Cornpicker, sheller, and dryer.....	8,000	560	7,440
With tractor.....	13,000	910	12,090
Mechanical cherry-picker and associated equipment.....	11,000	770	10,230
IRRIGATION SYSTEM (SOUTHEASTERN STATE)			
General farm.....	3,100	217	2,883
Tobacco farm.....	4,600	322	4,278
Peach orchard.....	8,900	623	8,277

Mr. MILLS. Mr. Chairman, I yield 5 minutes to the gentlewoman from Michigan [Mrs. GRIFFITHS].

(Mrs. GRIFFITHS asked and was given permission to revise and extend her remarks.)

Mrs. GRIFFITHS. Mr. Chairman, surprising as it may seem to some of my friends on my side of the aisle, I would like to say a few kind words about the tax-investment credit. It has been said both privately and publicly, and by polls taken in some newspapers, that this is really a bonanza for the rich. To some extent it is a bonanza. They are already permitted a 100-percent writeoff on their equipment in their plants, and this will give them 7 percent more. But it is not a bonanza aimed only at those who own plants; it is a bonanza aimed at the long lines of unemployment throughout this Nation.

Those lines of unemployment in our

hometowns that have been created in this country because of the lack of customers. America was the first nation that discovered businesswise that customers were better than colonies. You could pay any price for raw material if you could ask any price for the finished product. We are the largest sellers of goods abroad, but we regard that market as a secondary market. We are not too interested, really.

Today, however, through our own efforts we have poured our own treasure into building up the nations of the world. Therefore, it is essential that we be able to compete in the marketplaces of the world on a fair basis. That is all we are asking, not to lower our own standard of living, but to be able to sell. This bill is one attempt to make it possible for American industry to compete on a fair basis.

We have more equipment that is 10 years old than any nation in the free world. We give less of a writeoff. We have less capital formation on a percentage basis than any nation in the free world. We are up against the tough realities of life. We have to be able to sell, not alone in this Nation, not alone in Europe, but we must be able to sell in the rest of the Americas, in Asia, in Africa, and the only way we are going to be able to do it is to have productive machinery combined with the smartest management and the most productive labor in the world. Then we will be a great competitor.

This part of the bill is an earmarked tax reduction as opposed to an earmarked tax. It is an ear-marked tax reduction, to make possible the building up of additional and better equipment in this country in order to make us better competitors in the markets of the world.

I urge you to oppose the motion to recommit and to vote for the bill which will put America back to work.

Mr. BAKER. Mr. Chairman, I yield 5 minutes to the gentleman from Kansas [Mr. ELLSWORTH].

Mr. ELLSWORTH. Mr. Chairman, the administration's proposal to start taxing foreign income earned by overseas branches or subsidiaries of American firms is bad—bad for American workers' job security, bad for the gold flow problem, and bad for America's position as the powerful industrial and economic leader of the free world.

The administration's public relations campaign on this issue has been dominated by four myths—and these same myths have even cropped up here in committee debate yesterday and today. The administration and its followers continue to cling to the old mythology—probably mostly to avoid that very worst of Government embarrassments: the admission that they have been wrong all along.

The first myth we've heard is that American investment in Europe means less investment and so less jobs in the United States. Mr. Chairman, that is nonsense. Establishing plants in Europe has been imperative to preserve or create markets that would otherwise have been lost to European competitors. There was no chance of supplying those mar-

kets with goods made in America—because of transportation or other costs, or because of the necessity for close knowledge of local conditions, or because of other marketing or business reasons.

In fact, it is not possible to find any significant value or volume of imports back to the United States from branches set up abroad.

In fact, the opposite is true: Overseas branches and subsidiaries create and preserve job opportunity and security for American workers. In each of the last 4 years, for example, 19 big American firms alone sold over \$150 million worth of American-made equipment, components, supplies, and materials to their worldwide branches.

This ties in to the second myth: The outworn slogan that cutting down on European investment would substantially help the balance of payments, there is a grain of truth in this, as there is in all myths, but basically it is nonsense. Look at the facts.

With no allowance for offsets, the gross cost to our balance of payments, of the invasion of Europe in the peak year of 1960, was only \$280 million. Compare that figure with the \$31 billion of total payments by the United States, with the payment deficit itself of \$3,900 million, or with the payment outflow on direct investment account of \$1,700 million.

Moreover, the figures usually cited are phony because they include locally borrowed money—Belgian francs, for example, borrowed at subsidized rates of interest—and reinvested or plowed back

earnings of firms already established overseas.

Obviously, these amounts have no impact whatever on the American balance of payments and should not be included as if they did.

A third myth that administration followers have repeated over and over again, in an effort to sell their trade bill, is the myth that American firms establish branches in Europe to get inside the tariff wall around the Common Market. That is not so. They establish branches in Europe because the markets for their products are big and growing bigger.

I challenge anyone to name a single American company whose main reason for setting up operations in Europe was the new Common Market tariff.

The fourth myth is the false idea that the exclusion of oversea income from U.S. taxation was invented in the post-war period as an incentive for private investment. That is not so. The provision has been in the law since the Revenue Act was enacted in 1913, and it should be left there now.

To sum up, Mr. Chairman, I urge the committee to decide this issue on the basis of the facts, and its appreciation of the fast-moving world we live in—not on the basis of a series of myths, palmed off on us in the course of a high-powered advertising campaign.

The administration's proposal is bad—bad for American workers' job security, bad for the gold flow problem, and bad

for America's position as the industrial and economic leader of the free world.

I urge the committee to defeat this portion of the pending bill.

Mr. MILLS. Mr. Chairman, I yield 10 minutes to the gentleman from California [Mr. KING].

(Mr. KING of California asked and was given permission to revise and extend his remarks.)

Mr. KING of California. Mr. Chairman, I wish to address myself to what I consider to be the central issue in this debate, the matter of dividend and interest withholding.

The Republicans have described this provision as resulting in massive overwithholding. The description in my opinion does not square with the facts.

These are the simple facts.

First. At the present time, there is positive evidence of evasion to the extent of \$850 million in taxes a year. On this figure, there is no dispute.

Second. This is not corrected by publicity campaigns. A large-scale effort to tell dividend and interest recipients about their tax liability in 1959 did not reduce the tax evasion.

Third. This tax evasion will not be stopped by information returns and automatic data processing.

Fourth. The withholding provisions of the bill are simple and efficient. The overwithholding involved is completely trivial. I use the word "trivial" intentionally.

To indicate the magnitude of the evasion problem, I direct your attention to the following table:

TABLE 1.—Selected examples of substantial underreporting of dividends and/or interest in 1961 fraud-prosecution cases ¹

Case No.	Dividends and/or interest			Tax year	Adjusted gross income per return	Occupation of taxpayer	Case No.	Dividends and/or interest			Tax year	Adjusted gross income per return	Occupation of taxpayer
	Determined to be reportable	Reported on return	Under-reported					Determined to be reportable	Reported on return	Under-reported			
1	\$3,823	\$3,462	\$361	1954	\$10,727	Busdriver.	13	\$12,248	\$2,505	\$9,743	1955	\$13,501	Retail merchant, investor.
	5,303	3,995	1,308	1955	11,279	Schoolteacher.		14,640	2,901	11,739	1956	26,180	
	6,130	4,118	2,012	1956	10,631			9,209	3,137	6,072	1957	(17,968)	
	6,909	4,163	2,806	1957	10,499		14	16,703	-----	16,703	1955	(2)	Retired.
	7,089	4,007	3,082	1958	8,646			18,852	-----	18,852	1956	(2)	
2	1,284	-----	1,284	1954	1,518	Insurance agent and farmer.	15	19,100	-----	19,100	1957	(2)	
	1,319	-----	1,319	1955	2,639			866	113	753	1954	440	Chiropractor.
	1,403	-----	1,403	1956	4,571			1,189	114	1,075	1955	462	
	1,905	-----	1,905	1957	4,986			1,987	655	1,332	1956	2,424	
3	567	80	487	1954	(521)	Attorney.		2,618	1,105	1,513	1957	1,512	
	800	110	690	1955	528		16	3,590	480	3,110	1954	6,186	Dentist.
	1,233	148	1,085	1956	121			4,727	620	4,207	1955	4,400	
4	267	-----	267	1957	5,848	Farmer and dairy operator.		5,402	650	4,752	1956	7,720	
	2,149	-----	2,149	1958	5,485			6,305	732	5,573	1957	8,337	
5	3,353	924	2,429	1955	10,451	Insurance salesman.	17	7,283	1,991	5,292	1958	11,084	
	4,562	1,556	3,006	1956	8,810			2,648	-----	2,648	1954	6,207	Service station appliances.
	4,167	2,184	1,983	1957	7,375			4,484	-----	4,484	1955	6,185	
6	6,109	250	5,859	1954	1,581	Truck gardener.		4,514	-----	4,514	1956	6,613	
	5,778	-----	5,778	1955	1,640			4,584	-----	4,584	1957	6,805	
	5,704	-----	5,704	1956	1,604		18	1,893	-----	1,893	1954	2,216	Dentist.
	5,387	-----	5,387	1957	1,621			1,952	-----	1,952	1955	2,101	
7	493	-----	493	1954	(2)	Check casher.		2,129	-----	2,129	1956	2,133	
	591	-----	591	1955	(2)			2,257	-----	2,257	1957	780	
	728	-----	728	1956	(2)		19	4,181	51	4,130	1953	(21,027)	Drycleaning and laundry.
	636	-----	636	1957	(2)			3,800	-----	3,800	1954	(15,041)	
	901	-----	901	1958	(2)			4,666	2,100	2,566	1955	(5,834)	
8	1,002	-----	1,002	1954	4,025	Doctor.		8,499	1,556	6,943	1956	(735)	
	985	-----	985	1955	4,147			9,725	8,600	1,125	1957	14,079	
	1,301	-----	1,301	1956	(50)		20	6,916	1,533	5,232	1954	465	Fruit dealer and money-lender.
	1,473	908	565	1957	3,673			6,233	1,109	5,124	1955	(14)	
9	10,410	4,235	6,175	1953	4,403	Wholesale merchant.		7,088	897	6,191	1956	(524)	
	11,733	5,755	5,978	1954	558			8,435	871	7,564	1957	(612)	
10	13,336	11,977	1,358	1955	7,418	Attorney and tax practitioner.	21	8,906	1,439	7,467	1958	(483)	
	95	-----	95	1956	(2)			24,666	13,729	10,937	1954	5,490	Loan business.
	368	-----	368	1957	(2)			31,771	19,827	11,944	1955	13,540	
11	346	-----	346	1958	(2)			31,612	20,462	11,150	1956	14,039	
	802	-----	802	1955	7,951	Printer.	22	29,168	22,176	6,992	1957	16,561	
	1,068	-----	1,068	1956	15,198			8,125	1,723	6,402	1954	9,032	Attorney and farming rentals.
	2,428	-----	2,428	1957	14,275			11,417	1,252	10,165	1955	12,056	
	2,518	-----	2,518	1958	5,341			9,121	1,826	7,295	1956	19,431	
12	1,038	-----	1,038	1954	4,140	Dance studio manager.	23	2,602	-----	2,602	1954	5,680	Naval officer.
	1,220	-----	1,220	1955	2,576			2,082	680	2,762	1955	8,250	
	1,615	-----	1,615	1956	3,582								

Footnotes at end of table.

TABLE 1.—Selected examples of substantial underreporting of dividends and/or interest in 1961 fraud-prosecution cases ¹—Continued

Case No.	Dividends and/or interest			Tax year	Adjusted gross income per return	Occupation of taxpayer	Case No.	Dividends and/or interest			Tax year	Adjusted gross income per return	Occupation of taxpayer
	Determined to be reportable	Reported on return	Under-reported					Determined to be reportable	Reported on return	Under-reported			
24	3,621	270	3,351	1956	4,089	Ice company operator.	29	\$2,086	-----	\$2,086	1956	\$6,003	Funeral director.
	3,960	510	3,450	1957	6,677			3,076	-----	3,076	1957	6,191	
25	2,082	-----	2,082	1954	(2)	Attorney.	30	8,936	-----	8,936	1954	3,924	Engineer investor.
	1,741	-----	1,741	1955	(2)			14,681	-----	14,681	1955	4,914	
26	855	-----	855	1954	(2)	Insurance business.		23,338	-----	23,338	1956	4,380	
	1,811	-----	1,811	1955	(2)		31	1,059	-----	1,059	1954	(2)	Attorney.
	3,016	-----	3,016	1956	(2)			1,689	-----	1,689	1955	(2)	
	5,837	-----	5,837	1957	(2)			1,975	-----	1,975	1956	(2)	
27	2,427	813	1,614	1954	3,781	Salesman.		1,779	-----	1,779	1957	(2)	
	2,939	998	1,941	1955	3,416		32	4,489	\$397	4,092	1954	22,431	Partner, bottling company.
	3,334	1,214	2,120	1956	3,753			7,562	2,292	5,270	1955	34,020	Investor.
	3,848	1,633	2,215	1957	3,545		33	21,474	10,421	11,053	1954	6,886	
	3,909	1,942	1,967	1958	4,834			21,197	9,759	11,438	1955	9,455	
28	3,458	806	2,652	1954	3,412	Funeral home operator.		24,675	13,568	11,107	1956	11,450	
	5,250	757	4,493	1955	5,063		34	1,278	192	1,086	1955	12,999	Doctor.
	3,992	1,083	2,909	1956	3,935			1,439	137	1,302	1956	11,530	
	4,030	1,383	2,647	1957	577			1,347	130	1,217	1957	10,981	
29	990	-----	990	1955	3,997	Funeral director.		1,477	127	1,350	1958	12,841	

¹ Convictions secured during 1961.² No return.

Source: Treasury Department.

TABLE 2.—Selected examples of substantial underreporting of dividends and/or interest in 1960 fraud-prosecution cases ¹

Case No.	Dividends and/or interest			Tax year	Adjusted gross income per return	Occupation of taxpayer	Case No.	Dividends and/or interest			Tax year	Adjusted gross income per return	Occupation of taxpayer
	Determined to be reportable	Reported on return	Under-reported					Determined to be reportable	Reported on return	Under-reported			
1	\$6,110	\$250	\$5,860	1954	\$1,582	Farmer.	20	\$14,647	0	\$14,647	1952	(2)	Not stated.
	5,779	0	5,779	1955	1,641			14,989	0	14,989	1953	(2)	
	5,705	0	5,705	1956	1,605			15,412	0	15,412	1954	(2)	
	5,388	0	5,388	1957	1,621			16,704	0	16,704	1955	(2)	
2	4,490	397	4,093	1954	22,432	Picture theater.		18,852	0	18,852	1956	(2)	
3	1,962	871	1,091	1954	3,109	Maintenance service.		19,101	0	19,101	1957	(2)	
	1,994	837	1,157	1955	4,079		21	11,718	0	11,718	1954	(2)	Do.
	927	0	927	1956	4,912			15,266	0	15,266	1955	(2)	
	2,194	1,686	508	1957	8,379		22	3,132	0	3,132	1955	(2)	Do.
4	3,143	0	3,143	1953	1,490	Broker, sales.		2,640	0	2,640	1956	(2)	
	5,695	0	5,695	1954	1,501		23	973	0	973	1953	\$5,800	Store manager.
	6,046	0	6,046	1955	1,402			1,117	0	1,117	1954	7,446	
5	7,371	0	7,371	1953	4,366	Homebuilder and farmer.		1,423	0	1,423	1955	7,652	
	10,459	0	10,459	1954	24,464			3,609	0	3,609	1956	24,659	
6	16,321	3,449	12,872	1955	19,062	Furniture store.	24	422	0	422	1953	(?)	Farming.
7	7,009	3,030	3,979	1951	11,766	Attorney.		1,669	\$658	1,011	1954	3,923	
	5,947	3,439	2,508	1952	12,563			2,520	792	1,728	1955	2,907	
	5,631	2,899	2,732	1953	(831)			2,424	1,436	988	1956	424	
	11,725	7,709	4,016	1954	20,841		25	2,239	0	2,239	1953	8,615	Tax assessor and movie operator.
8	20,785	5,183	15,602	1954	8,403	Rental property.		2,486	0	2,486	1954	9,045	
	45,682	9,466	36,216	1955	33,776			3,113	0	3,113	1955	10,638	
	47,689	29,046	18,643	1956	45,069		26	7,504	4,976	2,528	1952	16,161	Miscellaneous warehousing and trading.
9	3,186	75	3,111	1954	4,249	Dentist.		5,303	5,271	32	1953	14,409	
	4,283	75	4,208	1955	4,400			7,456	5,646	1,810	1954	15,969	
	4,828	75	4,753	1956	7,720		27	2,334	361	1,973	1954	12,212	Physician and surgeon.
	5,665	92	5,573	1957	8,322			2,086	611	1,475	1955	13,668	
	5,292	0	5,292	1958	10,892			3,203	2,310	893	1956	14,203	
10	1,396	0	1,396	1953	3,289	Self-employed.		3,664	2,580	1,084	1957	16,336	
	1,576	0	1,576	1954	2,764			3,714	2,697	1,017	1958	15,445	
	1,835	0	1,835	1955	2,695		28	4,550	0	4,550	1953	1,632	Retired mail carrier.
	2,400	0	2,400	1956	4,240			4,654	0	4,654	1954	1,632	
11	2,377	0	2,377	1953	(863)	Cattle dealer.		6,010	0	6,010	1955	1,664	
	3,610	0	3,610	1954	4,736			7,308	0	7,308	1956	1,824	
12	12,473	6,128	6,345	1955	80,661	Executive.	29	12,721	4,043	8,678	1954	8,514	Dentist.
	15,216	6,442	8,774	1956	79,800			12,082	6,469	5,613	1955	11,247	
	21,777	18,947	2,830	1957	96,223			12,877	6,892	5,985	1956	11,950	
13	2,961	1,961	1,000	1953	12,438	Salesman and salesgirl.		14,902	8,390	6,512	1957	13,612	
	3,171	2,035	1,136	1954	12,637		30	5,504	523	4,981	1953	7,863	Not stated.
	3,677	2,269	1,408	1955	10,400			7,128	873	6,255	1954	9,038	
14	100,457	0	100,457	1953	(?)	Real estate.		8,453	1,023	7,430	1955	8,558	
	78,673	0	78,673	1954	9,554			10,262	1,523	8,739	1956	6,761	
	69,086	0	69,086	1955	8,558		31	7,226	121	7,105	1953	3,288	Self-employed.
	74,496	22,649	51,847	1956	382,043			6,706	1,508	5,198	1954	7,600	
15	3,140	0	3,140	1953	2,000	Extractor.		9,811	164	9,647	1955	10,652	
	3,109	0	3,109	1954	2,117			18,671	336	18,335	1956	10,762	
	3,269	755	2,514	1955	2,945			15,848	476	15,372	1957	13,610	
	3,231	1,420	1,811	1956	1,557		32	117,367	89,940	27,427	1953	89,940	Investments.
16	28,693	0	28,693	1953	(2)	Not stated.		113,671	93,532	20,139	1954	409,516	
	26,143	0	26,143	1954	70,347	Delinquent return.		66,592	60,325	6,267	1955	163,899	
17	1,778	325	1,453	1953	1,660	Farming.		112,950	91,410	21,540	1956	140,116	
	1,939	350	1,589	1954	2,124		33	5,515	2,548	2,967	1953	6,105	Printer.
	2,341	365	1,976	1955	1,960			4,903	2,023	2,880	1954	6,494	
18	2,347	1,119	1,229	1956	7,450	Not stated.		6,015	2,885	3,130	1955	7,846	
19	7,163	0	7,163	1955	16,876	Farmer.		6,803	3,426	3,377	1956	9,100	
	12,827	0	12,827	1956	16,239								

¹ Convictions secured during 1960.² No return.

Source: Treasury Department.

TABLE 3.—Selected examples of substantial underreporting of interest income uncovered in 1960 information document survey ¹

Case No.	Interest covered by information documents			Adjusted gross income per return	Payer of underreported interest	Case No.	Interest covered by information documents			Adjusted gross income per return	Payer of underreported interest
	Determined to be reportable	Reported on return	Under-reported				Determined to be reportable	Reported on return	Under-reported		
1	\$1,254		\$1,254	\$1,373	Commercial bank.	11	\$2,263		\$2,263	\$7,549	Credit union.
2	1,055	\$75	980	120,305	Savings and loan association.	12	1,552		1,552	5,681	Savings and loan association.
3	3,235		3,235	7,034	Corporation.	13	2,875		2,875	6,902	Corporation.
4	1,211		1,211	(2)	Commercial bank.	14	1,028		1,028	5,913	Commercial bank.
5	2,598		2,598	(2)	Corporation.	15	2,152		2,152	(2)	Life insurance company.
6	1,052		1,052	3,120	Commercial bank.	16	1,311		1,311	(2)	Commercial bank.
7	1,010		1,010	11,736	Savings and loan association.	17	2,636		2,636	6,534	Do.
8	1,468		1,468	102,330	Commercial bank.	18	1,227		1,227	21,084	Do.
9	946		946	9,163	Life insurance company.	19	1,952		1,952	55,062	Do.
10	1,015		1,015	373	Commercial bank.	20	1,200		1,200	54,520	Corporation.
						21	6,970		6,970	(2)	Do.

¹ Underreporting confirmed by audit.² None returned.

Source: Treasury Department.

TABLE 4.—Selected examples of substantial underreporting of dividend income uncovered in 1960 information document survey ¹

Case No.	Dividends covered by information documents			Adjusted gross income per return	Case No.	Dividends covered by information documents			Adjusted gross income per return
	Determined to be reportable	Reported on return	Under-reported			Determined to be reportable	Reported on return	Under-reported	
1	\$1,250		\$1,250	\$354	11	\$16,814	\$15,890	\$924	\$34,161
2	3,962	\$2,984	978	2,984	12	18,075	12,220	5,855	18,932
3	2,520	1,317	1,203	93,893	13	4,544	3,278	1,266	85,481
4	5,804	4,442	1,362	7,166	14	1,742	905	837	3,247
5	5,383	1,983	3,400	6,764	15	974		974	(2)
6	1,764	583	1,181	15,256	16	25,238	23,728	1,510	55,235
7	5,367	4,387	980	8,306	17	947		947	(2)
8	14,156	9,845	4,311	49,274	18	3,161	1,974	1,187	5,084
9	2,724	1,603	1,121	2,231	19	5,507		5,507	(2)
10	18,804	17,496	1,308	45,884	20	3,515		3,515	3,502

¹ Underreporting confirmed by audit.² None returned.

Source: Treasury Department.

In 1959, under Republican auspices, there was a massive public information program. Banks flooded their depositors with notices telling them that they should report and pay tax on interest income. Corporations included the same kind of notices with their dividend checks. Both the banks and the corporations saw the handwriting on the wall; they saw withholding in the offing if this publicity campaign did not work. What happened? There was, on the basis of comparative audits by the Internal Revenue Service, more underreporting in 1959 than there was in 1958.

What about information returns? The case has been put by the minority that this tax evasion on dividends and interests can be stopped by greater use of information returns along with automatic data processing. What this would require is that every bank and corporation would have to submit an information return on all the dividends and interest they pay. Then the machines would match these information returns with the tax returns of the recipients to find out what dividends and interest were not reported.

This system would require 750 million information returns, 750 million to be matched with about 60 million tax returns.

This would increase by five times the number of information returns that are now received by the Government.

The result of all this matching, after the cost of preparing the information

returns and preparing the information for the machines, is just a list of discrepancies which may be explained by other reasons than underreporting. In any case the discrepancies would have to be followed up by correspondence or office audits, with the taxpayer interrupting his own business to come to the Internal Revenue office, or by field audits with the agent going to the taxpayer's office. After settling the tax liability, it may still be necessary to use special collection procedures, tax liens, and the like, to get the money.

The Commissioner of Internal Revenue, the very capable Mortimer Caplin, has estimated that an information return procedure would produce only \$200 million of revenue at a cost of \$27 million. Withholding will produce \$650 million of revenue at a cost of only \$19 million.

I think it is clear that there is a massive tax evasion problem in the matter of dividends and interest. Publicity has not worked. Information returns will not work. Withholding, however, will work simply and efficiently.

Mr. McCORMACK. Mr. Chairman, will the gentleman yield?

Mr. KING of California. I yield to the distinguished Speaker.

Mr. McCORMACK. These are the people under the present law who are supposed to pay their taxes and are not paying them; is not that correct?

Mr. KING of California. The distinguished Speaker is precisely correct.

Mr. McCORMACK. I do not understand how any Members can permit a situation like that to continue when everybody else is covered by withholding, everybody who works, no matter where they are working. Here \$650 million is lost from people who are supposed to pay their taxes but are not doing so. I do not see how anybody can vote to eliminate the withholding feature of this bill.

Mr. KING of California. I certainly agree with the gentleman.

Under the bill, after exemption certificates, 15 million people will be subject to withholding. Out of these cases there will be overwithholding in only 2 million cases and in 1 million of these the overwithholding will be less than \$10. In virtually all of the other cases, there will be quarterly refunds.

Two million cases of overwithholding out of fifteen million. Only 13 percent. Seventy-three percent of the persons subject to wage withholding have overwithholding today and on wage withholding there are only annual refunds.

To call this massive overwithholding, as the minority does, is, and I am using a charitable phrase, misrepresentation.

Under the bill, the filing of exemption certificates will be extremely easy for those who expect to have no tax liability. The filing of refund applications will be equally easy.

Before voting on the motion to recommend, I want you to give serious thought to the matter of whose interest you are

serving. When you vote to delete dividend and interest withholding.

A vote to recommit is not a vote to protect low-income widows and orphans. They are protected under the bill.

A vote to recommit is not a vote to prevent massive overwithholding. Compared to what we now impose, with virtually no protest, on wage earners, the overwithholding on dividends and interest under this bill is trivial.

A vote to recommit is a vote for tax evaders, conscious or unconscious. The record is clear. The alternatives to withholding would not work. Withholding will work with minimum inconvenience to the people involved.

No doubt many people have written to you on the basis of frightening propaganda that they have been given about withholding. On any objective analysis of this problem, these scare stories have no substance. These stories have been manufactured by people who know what the facts are and they have been deliberately circulated among other people who do not know what the facts are. The membership of this House should not be taken in by such tactics.

Mr. BAILEY. Mr. Chairman, will the gentleman yield?

Mr. KING of California. I yield to the gentleman from West Virginia.

Mr. BAILEY. Mr. Chairman, I am concerned about a fixed group under this withholding provision of this proposed legislation. I am chairman of a subcommittee that is now conducting nationwide hearings in the field of aid to the aged. I should like the gentleman to explain, so the record will show clearly, what the situation is as it affects our older citizens who have some dividend and interest income. If it is true that nobody after retirement age will be covered by this bill, that answers a part of the problem. Could the gentleman from California say whether people who have reached the retirement age are exempt from the provisions of this bill?

Mr. KING of California. They are not exempt, but there are procedures designed to afford them relief.

Mr. MILLS. Mr. Chairman, will the gentleman yield?

Mr. KING of California. I am pleased to yield to the distinguished chairman of the committee.

Mr. MILLS. Is it not true that this matter of whether taxes on interest and dividends are to be withheld from a person above the age of 17 is dependent upon that individual's tax liability? If the individual at any age over 17 feels that he will not owe a tax on the amount of interest or dividend that he receives when he receives it, then he can advise the institution of that fact and there will be no withholding with respect to him, either of interest or dividends; is not that true?

Mr. KING of California. The chairman of the committee is correct.

Mr. MILLS. It should be borne in mind by the gentleman from West Virginia, our friend, Mr. BAILEY, that the people to whom he refers over 65 have what we call a double exemption. Instead of a \$600 exemption from income,

they are entitled to a \$1,200 exemption. A man and his wife, living together, filing a joint return would, therefore, get \$2,400 of income before they would be required to pay any tax, not taking into consideration any other deductions. So that most of these people to whom the gentleman refers would be entitled to file an exemption certificate and withholding would not occur against them.

Mr. BOGGS. Mr. Chairman, will the gentleman yield?

Mr. KING of California. I yield to the gentleman from Louisiana.

Mr. BOGGS. The additional fact is that it seems that most of these people are in a special category which is not subject to the tax.

Mr. MILLS. And, in addition, there is a \$50 exclusion with respect to dividend income, as the gentleman from California knows, so that all these things added together mean that most of the people over 65 will be entitled to file a certificate exempting them from withholding.

Mr. BAILEY. Mr. Chairman, will the gentleman yield further?

Mr. KING of California. I yield to the gentleman from West Virginia.

Mr. BAILEY. I would like the distinguished gentleman to clarify this situation. In the event an individual files a statement saying that they are not subject to the payment of taxes and files that with the concern from which they are getting their dividends or interest, and suppose that concern does not honor that affidavit or sworn statement and puts that person on the list for withholding, and I am thinking of a man and woman who are trying to live now on \$100 a month, and I certainly would not want to see them lose \$20 of that because the concern which was paying them the dividends or interest left them on the list to be withheld against and made the deduction.

Mr. MILLS. On the day that the individual is notified of the fact that there has been tax withheld unjustifiably, he can apply for a refund from the Internal Revenue Service, and we are assured by the Internal Revenue Service and the Treasury that these refunds be forwarded to the people in not longer than 3 to 4 weeks. Actually, there is not a lengthy period involved at present from the time of receipt of a claim for a refund and the time of the actual mailing of that refund. So that at the most, in the instance to which the gentleman from West Virginia refers, there need be a delay of no more than 3 weeks before this person would receive the refund.

Mr. BAILEY. I thank the gentleman.

Mr. MILLS. Mr. Chairman, will the gentleman yield?

Mr. KING of California. I yield to the gentleman from Arkansas.

Mr. MILLS. Would the gentleman from California restate the information he gave the House a few minutes ago on this question of overwithholding in the area of interest and dividends? The charge has been made, as the gentleman knows, that there would be massive over-

withholding, and that seems to justify some people in believing that no effort should be made to try to close this gap of escaping tax dollars that are presently due and owing on interest and dividends. Would the gentleman point out to the House what he said a few minutes ago with respect to the number? Did he say there would not be over 13 percent of people who draw interest and dividends who would be overwithheld on; is that the gentleman's statement?

Mr. KING of California. That is correct. The percentage is 13 percent.

Mr. MILLS. Did not the gentleman say that there are some 37 million people presently having salaries that are overwithheld on?

Mr. KING of California. The gentleman is correct.

Mr. MILLS. What percentage of people is that?

Mr. KING of California. The percentage of people there is 73 percent.

Mr. MILLS. And there are only 13 percent here; is that correct?

Mr. KING of California. The gentleman is correct.

Mr. GROSS. Mr. Chairman, will the gentleman yield?

Mr. KING of California. I yield to the gentleman from Iowa.

Mr. GROSS. The gentleman from Virginia [Mr. HARRISON] seemed to give the impression that all of these people were wealthy young widows. Does the gentleman concur in that and could he break that down to tell us what percentage of these are wealthy young widows?

Mr. KING of California. I am not able to answer that question.

Mr. Chairman, I suppose I have received more mail opposing the withholding provision than any other Member of this House, not only because of membership on the committee but also because I am a Representative from one of the largest districts in the country. It seems clear that the vast majority of these letters were stimulated. In most instances, I cannot remember the number, perhaps an aggregate of five or six hundred letters have been stimulated by corporations, or by institutions whose leaders through the last month or two have agreed with the Treasury officials that they can live with this provision; that they can live with withholding; that it is not going to immeasurably increase their employee team; and that it is not going to bring about a reduction in the interest paid or dividends.

I must add that I do not want to seem unsympathetic about this hardship. I only wish that some of this concern about aged couples might be expressed by the same Members who are now weeping about overwithholding when it comes to legislation that deals with aged people who are in need. While I have some concern for the overwithholding that will be imposed on the couple with several thousand dollars of dividend income, I must admit that I have greater concern for the aged couple that has several thousand dollars of medical expenses and no dividend income. I have greater concern for the aged couple who are

striving to make ends meet on inadequate relief payments.

Unfortunately, many of the people who have opposed dividend and interest withholding have used up all of their sympathy in bemoaning the plight of our senior citizens with common stock and have none left over for senior citizens with common sickness.

Of course, the matter of some overwithholding on aged couples has as much relation to the present problem as the famous red herring. It has been enormously exaggerated, frequently by the same people who show very little concern for legislation dealing with the welfare of elderly persons who are in need.

Mr. Chairman, I would like now to answer some specific points that are raised about withholding in the minority report.

First. ADP should be substituted for withholding.

The minority report stresses that the Internal Revenue Service is adopting an automatic data-processing system and that this, coupled with account numbers and information returns, should be used to collect the unreported tax on dividends and interest.

The report fails to state that an ADP-information return system would probably be more burdensome on the payers of dividends and interest, would be unworkable in some areas, and would, for a higher cost, recoup only one-third as much of the unreported tax as withholding.

Use of ADP-information returns would necessitate requiring information returns with respect to almost all dividend and interest payments. At present, only interest payments over \$600 must be reported and no reporting is required in the case of bond interest. Because of the millions of interest payments, the information return requirement would be very burdensome on the payers. When the purchaser of a bond receives interest only part of which is includible in his income, he nevertheless will be subject to audit since the information return will show him receiving the whole interest payment. On the other hand, there will be no information as to the amount taxable to the seller.

Even with an expanded information return system and a matching of these returns with the returns of the dividend and interest recipients, not one cent of tax would have been collected. There would have to be audit and enforcement followup in each case where a discrepancy is indicated. The Commissioner of Internal Revenue estimates that no more than \$200 million of the \$800 million annual revenue loss could be recouped through these enforcement procedures. This would be at a cost of \$27 million. For only \$19 million, withholding can recoup \$650 million each year and still leave free the ADP-audit procedures to recapture most of the remaining \$150 million of the yearly revenue loss.

Second. Overwithholding on wages example of problem in dividend and interest area.

The minority report states that, despite the allowance for personal exemptions and the standard deduction, wage

withholding results in 40 million annual refund claims. This figure is used to show the magnitude of the probable overwithholding on dividends and interest where no such allowance is permitted.

The minority report ignores the fact that much of the overwithholding on wages is voluntary through individuals claiming less than the number of exemptions to which they are entitled. This is done so that withholding will completely cover the wage earner's tax liability or as a form of savings. In addition, very few of the 40 million taxpayers who claim refunds complain of having to do so.

Third. Twenty-percent withholding rate exceeds effective rate of tax.

The minority report states that a withholding rate of 20 percent is higher than the average effective tax rate for most recipients of interest and dividends.

The 20-percent withholding rate equals the tax rate at the first bracket. While a taxpayer at the first bracket will have a somewhat lower effective rate because of the standard deduction and dividend exclusion and credit, it is not possible to set a withholding rate at the exact effective rate because of the need for an even gross-up factor.

In addition, many interest and dividend recipients are taxable at higher than the first brackets. For example, about two-thirds of the dividend and interest recipients who file tax returns have gross income over \$5,000. In comparison, almost two-thirds of those individuals reporting wages have gross income under \$5,000.

Fourth. Unclaimed refunds will be large.

The minority report states in several different places that withholding will result in a large windfall to the Government in the form of unclaimed refunds. As an example, it indicates that there are some 32 million bank accounts involving withholding of less than 40 cents, and that many of the depositors in these accounts will not undertake to file either an exemption certificate or a claim for refund with the result that these withheld funds will be a windfall to the Government.

These figures are very misleading. The 32 million accounts evidently include accounts paying no interest because they are dormant accounts or accounts where no interest is paid as a matter of bank policy. Therefore, this figure in itself is open to question.

However, even assuming they are correct, it is by no means true that all the withheld funds will be forfeited to the Government. First, many of these small accounts will be automatically exempt through the exemption for all school savings accounts without regard to the filing of exemption certificates. It is estimated that savings accounts of 6 million children will fall in this category.

Second, many of the depositors will have other income—such as wages—and, as a result, will owe tax for the year. These individuals are required to file income tax returns on which they will be able to take credit against their

tax liability for the 40-cent withholding. The returns will clearly show that these individuals must report their interest income and also that they may take a credit for any withheld tax. There should be no reason for them to forget to take the credit.

Third. Even though they owe no tax for the year, many of these depositors will be required to file tax returns because they have more than \$600—\$1,200 if over 65—of income. The returns will clearly indicate they are entitled to a refund.

Fourth. Many of these individuals will avail themselves of the exemption certificate procedure.

Therefore, after taking into account all these different situations, it seems clear that only a very small number of people will in fact forfeit their withheld tax.

Fifth. Estimate of unreported tax is overstated.

The minority report states that the Treasury estimate of \$800 million of unreported tax is grossly overstated.

These revenue figures are based on Treasury estimates from data compiled from 1959 returns—the latest data available. They are in substantial accord with the estimates of the prior Republican administration. For example, Mr. David A. Lindsay, former General Counsel of the Treasury, in an address before the Tax Institute Symposium on September 29, 1960, estimated that \$4 billion of interest and dividends were not reported on tax returns of individuals. To quote him:

Recent studies have indicated a gap in the amount of dividends paid to individuals and the amount of the dividends reported on individual tax returns of approximately \$1 billion, or failure to report about 10 percent of the total amount of dividends received.

It was also estimated that about \$3 billion of interest, which is about one-half of the interest received by individuals, was not reported.

Sixth. There will be massive overwithholding.

The minority report repeatedly states that the withholding system will result in "massive overwithholding." In this connection, it claims that very few people will be able to avail themselves of the exemption procedures. In addition, the minority argue that the quarterly refund mechanism will be available to only a relatively few individuals.

In this respect, the minority report misstates the facts. It is estimated that 22.5 million individuals receive interest and dividends. Only 2 million of these individuals will be subject to overwithholding and only 1 million of them to the extent of more than \$10 annually. Of the latter 1 million, those with annual income of less than \$10,000—\$5,000 if single—would be eligible for quarterly refunds.

In fact, overwithholding is almost completely avoided by the exemption system. Eight million nontaxable individuals would be eligible to file exemption certificates and, thereby, completely exempt their dividends and most forms

of interest from withholding. An additional 6 million schoolchildren would be automatically exempt from withholding on their school savings accounts.

Now, Mr. Chairman, I will speak on the treatment of foreign investment income which is provided by the Ways and Means Committee bill. Of the 12 sections of the bill dealing with foreign income and assets, the minority views concentrate on section 13, dealing with controlled foreign corporations. I will do likewise.

The separate views of the Republican members of the Ways and Means Committee are not very clear as to just why it is desirable to continue to allow American controlled foreign investments to continue to postpone payment of U.S. tax beyond citing a long parade of previous reports which have favored this. The recommendations of these reports, however, related to the special time and circumstance when the report was written.

The importance of considering the circumstances of each report is made clear on page B22 of the minority views. The statement is made about the policy of deferring U.S. tax on foreign investment income that "the concern of the Treasury stems from the fact that the policy succeeded. Western Europe was transformed from a debtor to a creditor of the United States. The policy was and still is sound." Look at that statement carefully. Tax policy is credited with changing Western Europe from a debtor to a creditor of the United States. The other side of this coin is that the United States was changed, with respect to Western Europe, from a creditor to a debtor. This is the policy that they argue "still is sound." It is sound, on their argument, to continue to build up U.S. debts to Western Europe. What kind of policy is this?

The committee bill recognizes that encouragement of foreign investment had some of the effects that the minority views attribute to it but it also recognizes that this is not always appropriate.

From the standpoint of the economy, there is always some benefit to investment and consequently we tend to look on foreign investment as a good thing because it is investment. Some of the mystery surrounding foreign investment might be removed if we catalog the benefits of investment and then ask how these are affected if the investment takes place abroad.

Investment increases the return on capital funds through the profit earned. In addition, investment increases productivity and thereby jobs and wages. It is clear from our own economic history that the increase in capital invested in American industry has enormously increased U.S. output and the share of labor in this increased output has remained remarkably stable.

Despite all of the mystery surrounding foreign investment, which is accentuated by dark references to the balance of payments, investment of American funds in foreign countries has the same kind of effects. It increases the return on American capital. The return on American capital invested abroad is apt to be relatively good compared to invest-

ment in the United States, because funds are being placed in a market where there is, relative to the United States, a capital shortage. On the other hand, many of these foreign investments have particular risk problems associated with them. On balance, the prospective profits must offset the extra risks because foreign investment is undertaken freely.

Foreign investment, like investment in the United States, does increase productivity and wages. Unlike domestic investment, however, the increase in wages and productivity is paid almost entirely to the nationals of another country, wherever the investment takes place.

I want to talk particularly about how these effects of investment work out in the relatively developed countries, such as Western Europe, Canada, Australia, and Japan. Before commenting on these, I will say that foreign investment in the less developed countries has significant advantages to the United States because it tends to bind these countries more closely to the Western Alliance. For investment in these less developed countries, some tax advantage is reasonable as an extension of the international political policy of the United States. The committee bill provides this.

In dealing with the more developed countries, however, we are dealing with our trading partners and our approach should be one of enlightened self-interest and not of disguised foreign aid.

Put on these terms, there is no great advantage to the United States in increasing productivity, jobs, and wages in countries like Japan and Germany instead of in the United States. The United States does not have an unlimited supply of investment funds. Actually, we are sufficiently concerned about our available investment funds that in this bill we are providing an investment credit designed to increase investment in American industry.

When funds of American investors are invested in Western Europe or Japan rather than in the United States, it is true that the American investors will derive dividend income from this investment. But this is the sort of return on investment which would arise even if the investment took place in the United States. The difference is that the investment return through increased productivity, higher wages and more jobs takes place in Western Europe or Japan rather than in the United States.

The minority views seem to imply that U.S. capital being invested abroad has no impact on the United States unless it is used to produce something for sale here in competition with U.S. producers. This is a very narrow view. Basically it is a use of capital that could have been employed to increase productivity in the United States. No matter how the investment is used abroad—to produce things for sale in the United States, to cut American producers out of an export market, or to develop a completely new product—this is capital not available in the United States.

A great deal of the investment each year is out of the internal funds of corporations, retained profits and the depreciation reserves. When American investment takes place in Western Europe

or Japan, these retained profits and depreciation reserves will now be in American-owned foreign corporations and are likely to be reinvested abroad instead of here. Foreign investment has a continuing tendency to build up productivity, jobs and wages abroad, rather than at home.

How is all this related to trade? So far as trade in commodities is concerned, the United States still has a favorable balance although our wage rates are higher than those of any other country. The fact is that the United States has such an advantage in productivity arising from the level of education of our workers and from the quantity of capital which our workers use that they can pay the higher money wages and still compete in most products. In many particular lines of products, the rapid improvement of productivity in Western Europe and Japan has cut into this United States advantage and we find ourselves less competitive.

The basis of the controlled foreign corporation provisions of the committee bill is simply that the present law does not justify continued unlimited deferral as an encouragement to investment of new U.S. funds in the developed countries. Encouragement to U.S. capital to invest in the developed countries makes investment and productivity there higher than it would have been anyway, and investment and productivity here lower than it would have been.

An American business firm might be considering a domestic investment that would promise a return on the investment of 20 percent a year, which after the U.S. taxes would be reduced to 10 percent a year. The same firm might have the possibility of investing abroad in a project which, after making an allowance for the special risks of foreign investment, would return 16 percent a year but which would be taxed at only 25 percent.

On a before-tax basis, the U.S. investment is clearly the more efficient, a 20-percent return compared to a 16 percent return. On an after-tax basis, however, the parent company would realize only 10 percent on its U.S. investment and 12 percent on its foreign investment.

This is the distortion of investment decisions which the committee bill wants to end. The committee bill does not penalize foreign investment. The foreign tax credits are still available as they are under present law, but by reducing the opportunity for the parent company to defer tax on income earned through a foreign subsidiary we simply bring the tax treatments closer together. A foreign investment which is relatively inefficient compared to a U.S. investment will be less likely to appear efficient on an after-tax basis.

In view of the fact that American labor has a substantial interest in domestic investment to increase its productivity and wages in this country, this is a minimum requirement. We are not penalizing; we are just reducing the special encouragement. The fact that the investors themselves might retain a higher portion of their profit when the investment is foreign should not be con-

trolling when we are considering the interests of all of the people in the United States.

The Ways and Means Committee bill does not go as far as achieving complete equality in applicable tax rates on U.S. funds invested in developed countries and in the United States. The committee was impressed with the problem faced by American investors who have a going business situation in the developed countries. A heavier tax on their retained earnings than that on their immediate foreign competitors would be a handicap. The committee bill permits continued deferral on the operating income of an American-controlled foreign corporation which is reinvested in substantially the same trade or business which the controlled corporation is conducting.

The committee bill also recognizes the national advantages of encouraging investment in the less developed countries. Certain income which is invested in those countries is permitted to continue to enjoy deferral even though the investment in a less developed country might be in a new trade or business.

The committee bill is a realistic adaptation of foreign economic policy to the 1960's. It is not subject to the attack made by the minority views in the committee report that this does not conform to the foreign economic policy of the 1940's and the 1950's when we were participating in the economic recovery of Western Europe and Japan. In the words of the minority views themselves, we have gotten Western Europe out of the debtor class. We do not have to continue making the United States more of a debtor by encouraging investment that raises productivity, jobs, and wages in Western Europe and Japan at the expense of the United States.

The committee bill treatment of foreign investment income is consistent with the word "reciprocal" in our reciprocal trade program. Reciprocal trade is based on open competition. By removing trade barriers, it lets countries realize their respective productivity advantages in developing foreign markets. Under freer trade, the countries of Western Europe and Japan would realize some of the productivity improvements that have come about through recent investment in those countries in the same way that the United States will be able to realize all the productivity improvement arising from its own investment. In this open competition between productivities, there is no justification for our continuing to provide favorable tax treatment to investments which increase productivity abroad compared to investments which increase productivity at home.

Mr. Chairman, I urge rejection of the motion to recommit, and I urge passage of the bill.

Mr. BAKER. Mr. Chairman, I yield such time as he may desire to the gentleman from New York [Mr. OSTERTAG].

(Mr. OSTERTAG asked and was given permission to revise and extend his remarks.)

Mr. OSTERTAG. Mr. Chairman, I rise in opposition to this tax measure in its present form and ask unanimous con-

sent to revise and extend my remarks. Two glaring deficiencies and inequities in the Committee bill cause me to rise in opposition to the bill, even as it is proposed to be amended by the committee.

The first of these is the 7-percent investment credit—which I understand business has not asked for and does not want—and which even former President Truman's economic adviser, Leon Keyserling, calls a tax bonanza.

Members of the Ways and Means Committee have said repeatedly that this proposal perverts the tax laws into an annual subsidy to one segment of the American business community and constitutes a discriminatory loophole which must be dealt with by future Congresses. Note that the windfall from this proposal would be enjoyed by only one segment of the business community. It ignores the service industries and the distribution and retail segments of our economy. It favors the large and penalizes the small.

The Committee has recognized that the proposal in its original form would have created tremendous inequities even among the relatively few businesses which would benefit from it. So, the committee has offered an amendment which would limit the windfall to any one company. When we find that a windfall has to be limited, are we not required to find that the whole proposal is a bad one? Can a limitation make it better? I believe there is no such thing as being a little bit evil.

In addition, let me point out that this tax proposal would not accomplish the objective the administration claims for it. Almost without exception, every major organization testifying before the Committee, including both the chamber of commerce and the AFL-CIO, opposed the proposal, either doubting that it would produce the benefits claimed, or maintaining the plan was discriminatory.

When a bad bill produces limited windfalls for only a few—when even these few do not want it—and when the only other result is a revenue loss of more than \$1 billion, we have no choice but to refuse to enact it into law. I believe the Committee has no choice but to agree to remove this section.

Again, Mr. Chairman, section 19 of the bill, providing for withholding on interest and dividends, attacks the historic American principle of voluntary self-assessment, which is the foundation on which the American tax system has produced more revenue—voluntarily—withstanding excessively high rates, with greater compliance than any other revenue system in the world.

In addition, withholding on interest and dividends is an administrative monstrosity. It cannot possibly be handled in the same manner as withholding on wages and salaries. The Ways and Means Committee had great difficulty in finding procedures they thought even workable, and the procedure adopted by the Committee at the last minute will produce administrative chaos, as well as the further inequity of massive over-withholding. Any additional revenue

produced by the measure—and I cannot believe it could possibly be as large as the administration claims—would have to be gobbled up by the increased cost of managing this tremendous administrative job.

But, the greatest evil in this withholding proposal is found in the hardship to the small investor and the small depositor. More than 3 million of the shareholders in American industry are in the low-income group. We have exempted \$50 in his dividends from tax. Now, we are asked to nullify that exemption by a withholding tax, even where there is in all likelihood no tax liability. Many of these shareholders will find the filing of claims too onerous, or will overlook filing claims for the refund of nominal amounts.

In addition, more than 7 million depositors in savings and loan associations receive interest, or dividends, of less than \$10. And there are 32 million bank accounts which would involve the withholding of less than 40 cents.

The claim has been made that, since we have withholding on wages and salaries, this is no different. On the contrary, there is a world of difference. In the case of wages and salaries, there is only one employer-employee relationship, only one withholder, only one reporter. But with this proposal, we would enforce a withholding relationship whose ramifications are endless and beyond imagination.

Beyond this, we would force every individual who owns a few shares of stock, every individual who has a savings account, in other words, every individual who practices the good old-fashioned American virtue of thrift—we are going to force him to determine what has been withheld. We are going to force him to perform mathematical gymnastics every year—or every quarter—to determine what the Government owes him as a refund. We are going to do this, because the administration and the Ways and Means Committee could find no answer to the problem of asking the companies and financial institutions to report to the taxpayer the amounts they have withheld on his account. We must protest any such additional burden on the already overburdened taxpayer.

I could cite further horrors about this proposal—its inequity regarding churches, charitable organizations and pension funds, the tremendous book-keeping and reporting load placed on our businesses and financial institutions. But, the real evil, the greatest hardship, is the burden on the individual, and particularly the individual who needs all of the product of his labor.

It is for these reasons, Mr. Chairman, that I believe we must vote to strike these provisions from the bill. I hope all Members of the House who truly have concern for the best interests of the people of America will join me in this conviction and belief.

Mr. BAKER. Mr. Chairman, I yield 7 minutes to the gentleman from New York [Mr. BARRY].

(Mr. BARRY asked and was given permission to revise and extend his remarks.)

Mr. BARRY. Mr. Chairman, I believe that the Revenue Act of 1962—H.R. 10650—is seriously defective for the reason that it represents an attempt to influence foreign policy through taxation. This is especially objectionable since, as I now understand it, the Ways and Means Committee did not, in fact, conduct any hearings on certain complicated provisions of the present bill dealing with controlled foreign corporations.

It is true that the majority report recognizes "the need to maintain active American business operations abroad on an equal competitive footing with other operating businesses in the foreign countries"—page 62. The majority report also recognizes that "the location of investments in these countries is an important factor in stimulating American exports to the same areas"—page 57.

In this regard, I would like to refer to a statement by the Otis Elevator Co., which appeared in the CONGRESSIONAL RECORD of January 30, 1962. It points out that, although Otis has preferred to supply foreign markets by exporting from the United States, it was at times necessary to locate abroad in order to maintain its position in elevator markets throughout the world. Despite an initial adverse effect on the balance of payments, Otis has, over the past 15 years, brought into the United States more than \$12 million for each million sent out in loans and investment.

The statement also points out that over 90 percent of the \$63 million worth of equipment Otis has exported over the past 15 years has gone to countries where Otis has its own organization. This investment, therefore, has resulted not in an export of jobs as is often claimed by the Treasury Department, but is the direct cause of a great many jobs which otherwise would not now exist.

Apparently the Ways and Means Committee was unanimous in believing it would be a grave foreign policy error for the U.S. Government to carry out the request of the Treasury Department, that full U.S. income tax be imposed upon foreign subsidiaries of U.S. companies at the operating level. On this subject, the committee found:

To impose the U.S. tax currently on the U.S. shareholders of American-owned businesses operating abroad would place such firms at a disadvantage with other firms located in the same areas not subject to U.S. tax (pp. 57-58).

Despite these reassuring utterances from the committee's report, an examination of the actual provisions of section 13 of the bill itself discloses that the committee has in fact adopted much of the philosophy which these quoted phrases from the report seem to reject. I am afraid that the casual reader of the bill and the committee report might be led to the conclusion that the bill is merely designed to reach such things as passive income or personal holding company-type income or tax-haven income or income siphoned abroad but in truth derived from activities carried on within the United States.

Let me say that if the proposed new taxes were confined to these kinds of

income, it could properly be regarded as a true tax-haven measure free from foreign implications. According to my information, this area of the bill was so limited until approximately 2 weeks ago, at which time this portion of the bill was suddenly removed from normal committee drafting channels and substantially overhauled and redirected into its present condition.

The result of this maneuver is the bill now before us, the provisions of which have been public for only 10 days. The Ways and Means Committee did, in fact, consider and reject the entire original philosophy of the Treasury Department with regard to a current taxation of foreign earnings, as noted earlier. The committee and its staff did consider and did unanimously adopt provisions designed to reach true tax-haven operations. But the effect of the present section 13 has never been the subject of any hearings by any committee of the Congress, except in a very general way.

Under the circumstances, only a handful of Members of the Congress and the few interested public at large have had time to comprehend the revolutionary impact which these complicated measures will have. Moreover, the committee bill, as now constituted, would have the following effect on our economy:

First. Any first-time investment in a developed country, such as Western Europe, would be a so-called nonqualified investment for tax purposes. This means that no American manufacturer, no matter how difficult it might be for him to export his product to Europe, would be able to enter that market, except under a tax burden which would not be fully borne by his European competitors. This does not sound solely like a tax measure to me, but rather as an indirect attempt to regulate the flow of competitive American capital.

Second. U.S. manufacturers already in Europe will be allowed to go into production of new lines only upon payment of this added U.S. tax at the European operating level which will retard growth of U.S. firms in European markets. Since present tax laws on foreign dividends are merely deferred until brought into the United States it is self-deluding to estimate that this measure will create sufficient new tax revenues to materially offset the cost of the domestic investment credit.

With regard to our competitive ability, foreign observers seem to realize the disadvantages to many U.S. companies which apparently the administration fails to recognize. For example, the March 10 issue of the Financial Post of Toronto, Canada, carried an article entitled "Here's Where United States Aids Rivals in Other Markets," which says in part:

It is certainly clear, in the field of foreign trade, that a foreign corporation controlled by Canadians, or an overseas trade corporation in Britain, will have a decided advantage over its U.S.-owned competitors after the New Frontier people in Washington achieve their ends. The new law will also serve to trim American sails in Europe, increase the downward pressure on the U.S. dollar, and indirectly assist Britain's entry in the Common Market.

Let's hope that Ottawa encourages Canadian business to take full advantage of the mistakes south of the border.

Third. The claim that the bill reaches only passive, rather than operating, situations is not correct. All large, widely held manufacturing corporations derive income in the form of interest from installment sales, rentals of equipment and dividends from local operating affiliates. In such situations, this is normal operating business income. Yet this bill treats such income as personal holding company income, without regard to the kind of operation in which it is produced.

Fourth. For some reason not made clear the drafters of this bill have taken a dislike to the oversea use of a centralized multicountry selling company, organized to sell U.S. products made abroad. Let us suppose the case of an American firm in the Common Market, which has been manufacturing various products in different countries over a period of many years. Instead of having an operating sales force attached to each plant, the company concludes to set up a centralized sales company and sales force. This will reduce operating expenses and render the company's products more competitive throughout the market and in areas outside the market, such as north Africa and the Middle East. For some undisclosed reason the drafters of this measure object to that, even though no element of avoidance of U.S. tax is in any way involved in this situation.

Fifth. In one other respect, the provisions of H.R. 10650 deal with operating foreign earnings rather than so-called tax-haven income. The Treasury Department, under this bill, would have power to determine what amount of a company's foreign income should be attributed to patents, copyrights, formulas and processes originally developed in the United States. This could cause many problems as I doubt that many American oversea subsidiaries operate without using some processes which were originally developed in the United States. I feel certain that an attempt to break down gross income from a particular sale of a product, as between amounts attributable to this kind of intangible process, on the one hand, and to production, distribution, advertising, management and on the other hand, would present a fantastic problem. Obviously, this bill goes far beyond the taxing of patents which have been assigned to shell corporations overseas and there licensed to foreign operators.

We should not consider this bill as an isolated tax measure and ignore the effect it will have on our foreign policy. Hearings are already underway to consider the Trade Expansion Act of 1962, in which the President asks for significantly increased authority to lower American tariffs so that foreign trade barriers will in turn be lowered for American exports. Many companies, however, cannot compete through exports alone, as they find that often they must compete from within a foreign market or get out. Surely at this mo-

ment, when we are on the verge of entering a new era of foreign trade, it would be unwise as well as unfair to penalize those companies whose foreign interests, such as those of the Otis Elevator Co., are directly responsible for a healthy balance of exports.

Finally, we must remember that our foreign relations are not dependent solely upon our diplomatic corps, but also upon our private firms abroad. By working in harmonious cooperation and competition with all sectors of a foreign community, these firms are not only a source of profit to the United States but a source of strength in tying together the free community of nations. To place prohibitive restrictions against them will in the long run weaken not only our own country's position abroad, but the entire free world.

Mr. Chairman, although taxation has been a subject of keen interest to me over two decades I cannot qualify as an expert on the meaning of this bill, since I have only had a few hours to consider these complicated provisions. Nevertheless, I will say this: I have become satisfied that many features of this bill impinge heavily upon the area of our national foreign economic policy, and are, as my distinguished colleague from Missouri [Mr. CURTIS] has noted, isolationist in concept and discriminatory in effect. Before they are enacted into law I am convinced that interested members of the public should be given a full opportunity to consider and study these proposed measures and to testify as to their desirability and effect before the appropriate committees of this Congress.

Personally, I doubt very much that our tax laws should be used as an instrument to retrench America's position in the world's markets. Even more do I doubt that this should be done in haste and without adequate hearing. The House should not pass on to the Senate ill-considered, complicated, or slovenly legislation on the unsound theory that the Senate will correct its imperfections.

Mr. MILLS. Mr. Chairman, I yield such time as he may desire to the gentleman from California [Mr. ROOSEVELT].

(Mr. ROOSEVELT asked and was given permission to revise and extend his remarks.)

Mr. ROOSEVELT. Mr. Chairman, the Committee on Ways and Means is to be congratulated for their combined efforts in the development of their report accompanying H.R. 10650.

The tax bill, as presented, will go a long way toward closing the present tax loopholes which have allowed too many Americans to escape their just tax obligations.

The effect of this bill will be felt in southern California where so many Americans have been deprived of their income as a result of the general exodus of American capital and American motion picture stars to foreign countries because of tax advantages available under prior tax laws.

The limitation of \$20,000 per year for the first 3 years, and \$35,000 per year

thereafter, on the tax-free income that nonresidents may bring home will act to stop the trend of runaway film production. I hope the industry realizes southern California is the home of the film industry and that this foreign runaway production should come home.

Those who have helped make this industry successful—the electricians, the grips, and other related crafts—should not be penalized because the producers and stars have been able to run away through a tax loophole.

Again I wish to commend Mr. MILLS, Mr. KING, and others of the Committee on Ways and Means for their efforts which have gone a long way toward putting a stop to this "run away" motion picture film production. I also trust the industry will realize the Congress will do whatever is necessary in the future to keep this industry at home and, because of this realization, I hope they will more carefully police their own activities, and unite wherever possible for measures in the general interest of the industry.

It is true that some inconvenience will come to some persons who will have no tax liability by the withholding provisions of this bill. But this is far outweighed by the large revenue which will be collected from those who actually owe it and who today are receiving an undeserved and unfair exemption. Once this is understood, I believe most good citizens will, perhaps with some annoyance, comply fully with the law.

Mr. MILLS. Mr. Chairman, I yield 10 minutes to the gentleman from Florida [Mr. HERLONG].

Mr. HERLONG. Mr. Chairman, my concern about this bill has been with the overall revenue effects of it as it was brought out by the Committee on Ways and Means and as it will be amended by committee amendments which will later be proposed.

The categorical statement has been made that this bill as brought out by the Committee on Ways and Means is not in balance from a fiscal standpoint.

Mr. Chairman, I want to state at this time that in my judgment the bill as developed by the Committee on Ways and Means will not operate to unbalance the budget for fiscal 1963 or later years but will, on the contrary, contribute toward a surplus.

In estimating the revenue consequences of a measure of this scope, a number of considerations must be taken into account. The estimated effects will vary with the basis of comparison we use and the time periods being considered.

One convenient and commonly used basis for evaluating revenue measures is the gross full year effect after all features of the bill are fully effective. This means offsetting the gains and losses directly and immediately involved in the legislation without allowance for indirect or side effects. On this basis the direct estimated revenue effect of this bill, as it will be amended by the Committee on Ways and Means, would be to increase revenues by \$120 million a year. This type of estimate is presented in a table which the Treasury Department has prepared which shows the extent to which

the direct loss from the investment credit is offset by other provisions of the bill when all are fully effective. These estimates are based on 1962 levels of income, and this is another thing we have to take into consideration.

This relatively simple approach is useful for some purposes, but it has obvious limitations for some types of revenue estimates. The indirect or side effects of changes in economic conditions may be highly important factors that must be allowed for in estimating some revenue changes. For example, the estimates of tax yields in the President's budget messages and in midyear reviews of the budget are always predicated on the levels of income and profits which are expected to prevail and the revenue estimates, as you know, are revised as expectations of income levels change.

It should be noted that in considering earlier tax bills allowances have been made for the stimulative effects of proposed tax changes on revenues. Spokesmen for the previous administration testified before the Senate Finance Committee in 1954 that the revenue loss that might be expected from more liberal depreciation allowance would be largely recouped through the resulting expansion in investment corporate profits, individual incomes, and employment.

The anticipated effects on economic conditions are of particular significance for the current bill. The purpose of the investment credit is to stimulate increased investment and increase economic growth. The indirect effects on the economy and levels of income must also be estimated and taken into account to obtain a realistic picture for Federal budget purposes. The overall result when all the provisions are fully effective will thus be a net gain in revenue substantially greater than the \$120 million that might be expected if we still operated on a static basis and if there were no improvements in our economy by reason of this tax credit.

For estimates of revenue effects for fiscal year 1963 we must also take into account the varying effective dates of provisions in the bill. Some are effective as of the start of this calendar year, some next January 1, and one becomes effective on July 1 of this year. Accordingly, the results that we can expect in the fiscal year starting July 1, 1962, will be different from those of a full year in which all of the provisions have had the opportunity to become fully effective.

Mr. Chairman, the Treasury Department estimates for fiscal 1963 for the bill as amended by the Committee on Ways and Means, these figures show a fiscal year revenue loss for the investment credit of \$560 million. Then we offset that by a gain of some \$240 million from other provisions of the bill. The net revenue loss, then, for fiscal 1963 would be \$320 million. However, these figures give inadequate recognition to the stimulative effects of the credit. These figures allowed for some expansion of investment and rise in incomes, which was computed from statistical relationships in past years between investment and gradual changes in the cost

of capital goods and cash flows. But these figures do not allow fully for the market change in the area of investment decisions that will be made by the enactment of the credit. We may confidently expect a sharp rise from the old, established trends as the advantages of the credit bring a quick and substantial shift in the relationship between net investment costs, cash flows, and rate of return from capital goods.

Mr. Chairman, when full recognition is given to the change in levels of investment and incomes that will result from enactment of the credit we must anticipate larger tax bases and a rise in tax revenue.

Mr. Chairman, the Secretary of the Treasury has said that in view of all these factors he is confident that enactment of this bill without any amendment to it, except the committee amendments, will not result in an overall revenue loss to the Government in fiscal 1963, but will, in fact, provide a net gain. The net gain will be larger in successive years as the rates of investment and economic growth are enhanced.

Mr. Chairman, revenue estimates running some 15 to 16 months ahead are, of course, only approximations at best. But if we are to act prudently we must endeavor to appraise all of the relevant factors as carefully as we can. I believe the analysis and appraisal provided by the Secretary of the Treasury is as complete and sound as any we could make at this time. I am pleased to note that he shares my conviction that this bill as developed by the Committee on Ways and Means will make a net contribution to the tax revenue in fiscal 1963 and an even greater contribution in future years.

The details of these estimates are as follows:

TABLE 1.—Treasury Department estimates of revenue effect¹ of bill as amended by the Committee on Ways and Means when changes are fully effective, without taking into account the effect on the economy of the provisions

[In millions of dollars]

Revenue bill of 1962:	
Investment credit.....	-1,175
Withholding on dividends and interest.....	+650
Mutual banks and savings and loan associations.....	+200
Entertainment expenses.....	+125
Capital gains on depreciable property.....	+100
Mutual fire and casualty companies.....	+40
Cooperatives.....	+35
Foreign items:	
Controlled foreign corporations.....	+85
Gross-up of dividends.....	+30
All other items relating to taxation of foreign income, etc.....	+30
Total.....	+120

¹ At levels of income and investment estimated for the calendar year 1962 except that the estimate of revenue gain from change in taxation of mutual banks and savings and loan associations is based on income levels for the calendar year 1963, the 1st year affected.

² Assumes transitional period has been completed for fire and casualty companies.

³ The revenue estimates for the controlled foreign corporation provision do not take into account additions to the tax base, in the form of royalties, rents, etc., which reliable evidence indicates will be forthcoming but which cannot be quantified with an acceptable degree of accuracy.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Mar. 26, 1962.

TABLE 2.—Treasury Department estimates of revenue effect of bill as amended by the Committee on Ways and Means (see note) for the fiscal year 1963 taking into account its estimate of effect on the economy of the provisions

[In millions of dollars]

	Revenue effect	Effective date
Revenue bill of 1962:		
Investment credit (see note).....	-560	Jan. 1, 1962
Withholding on dividends and interest.....	+195	Jan. 1, 1963
Mutual banks and savings and loan associations.....		Do.
Entertainment expenses.....	+40	July 1, 1962
Capital gains on depreciable property.....		Jan. 1, 1962
Mutual fire and casualty companies.....		Jan. 1, 1963
Cooperatives.....		Do.
Foreign items:		
Controlled foreign corporations.....		Do.
Gross-up of dividends.....		Do.
All other items relating to taxation of foreign income, etc.....	+5	Do.
Total (see note)....	-320	

NOTE.—In estimating the net revenue cost of the investment credit, its favorable effects on the level of investment were computed from statistical relationships in past years between investment and gradual changes in the cost of capital goods (profitability) and cash flow. This procedure thus does not take into account the especially favorable impact on businessmen's decisions to invest of the sudden improvements in these factors resulting from the enactment of the credit. Taking this into account should produce more favorable effects than the table shows for the investment credit. It will eliminate the overall net revenue loss for the bill as a whole and instead would yield an overall net gain.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis, Mar. 26, 1962.

Mr. BAKER. Mr. Chairman, I yield such time as he may consume to the gentleman from California [Mr. BALDWIN].

(Mr. BALDWIN asked and was given permission to revise and extend his remarks.)

Mr. BALDWIN. Mr. Chairman, I rise in opposition to H.R. 10650. This bill in its present form would not, in my opinion, provide any financial assistance to our U.S. Treasury. In fact, it would actually reduce our revenues during fiscal year 1963. The budget for fiscal year 1963 is precariously balanced at the present time. The President this week submitted to Congress a request to appropriate \$600 million for an immediate public works program, of which \$350 million would be applicable to fiscal year 1963. This would reduce his estimated budget balance for fiscal year 1963 to only \$113 million. H. R. 10650 would turn this narrow surplus into a deficit for fiscal year 1963.

Although this tax bill proposes to close certain loopholes it would open a new loophole in the form of a 7-percent tax credit for purchase of equipment by business concerns, which would be as big a new loophole as all existing loopholes which are supposed to be closed by this bill. Therefore, nothing would be gained in the way of financial revenues for the Treasury. I do not believe we should grant a 7-percent tax credit at the present time in view of our high level of Federal expenditures. I see no justification to allow a business firm not only to write-

off 100-percent depreciation on equipment but also to be able to take a 7-percent tax credit off its net tax bill as well.

Mr. BAKER. Mr. Chairman, I yield such time as he may consume to the gentleman from California [Mr. ROUSSELOT].

(Mr. ROUSSELOT asked and was given permission to revise and extend his remarks.)

Mr. ROUSSELOT. Mr. Chairman, I rise in opposition to H.R. 10650, the Revenue Act of 1962.

My reasons for opposing this legislation are:

First. Enforcement of withholding tax on dividends and interest would be a bureaucratic nightmare. Canada has repealed a law requiring a withholding tax on dividends and interest because it was impossible to administer. I say that instead of the withholding tax we should enforce with greater vigor the existing tax law respecting dividends and interest.

Second. It does not give a much needed tax break to large and small retail distributors. I believe these types of businesses should be allowed to defer taxes in an amount equal to 20 percent of their investment inventory.

Third. The 8-percent investment tax credit for manufacturing firms puts the bill in the red by at least \$400 million. This flies in the face of the admonition expressed in President Kennedy's 1962 budget message:

To plan a deficit would increase the risk of inflationary pressures, damaging alike to our domestic economy and to the international balance of payments.

I think a far sounder approach to the problem of how to encourage more capital investment is to allow a more liberal depreciation allowance than present law permits. A more liberal depreciation allowance for all businesses, not just a few, would help to create the desire on the part of businessmen to expand and modernize their enterprises. This creates one united front within our free enterprise system. The bill before us is discriminatory against small businesses.

Fourth. The tax on foreign subsidiaries of domestic corporations provided for in H.R. 10650 is discriminatory. The subsidiaries will have to pay taxes to the U.S. Government as well as to the governments of the countries in which they are located. Secretary of Commerce Luther Hodges has stated that foreign subsidiaries are an important adjunct to our domestic economy. It seems unwise, therefore, to increase their tax burden and thereby weaken their ability to compete with foreign corporations.

Fifth. For some years there has been a desire to place an equitable tax levy on cooperatives; however, if there is to be a tax on cooperatives such as H.R. 10650 proposes, it should apply to all cooperatives. I strongly urge the defeat of H.R. 10650 so that a new bill can be considered by the Ways and Means Committee.

Mr. BAKER. Mr. Chairman, I yield such time as he may consume to the gentleman from Ohio [Mr. HARSHA].

(Mr. HARSHA asked and was given permission to revise and extend his remarks.)

Mr. HARSHA. Mr. Chairman, I find myself in a rather unique position when considering this tax measure. On the one hand, my Republican friends have adopted the position that the tax credit proviso is not the most acceptable and best method for providing tax relief to certain of our industries. They prefer an accelerated rate of depreciation. With this, I find I must agree. However, on the other hand, I find considerable merit in the tax credit approach and I would like to explain to my colleagues my reasons, with the hope or thought in mind that if not today, at some future date, this type of tax incentive be added to the law.

While I agree that the change in depreciation rates will provide the most equitable tax incentive without discrimination to all concerned, I still believe there is considerable merit to the tax credit approach for new investment.

The administration has admitted that the recovery from the so-called recession has not been as full or as rapid as was anticipated. Unemployment is considerably higher than desired. So the President is asking for an additional \$0.6 billion to construct public works projects in the depressed areas to help alleviate unemployment and to encourage economic development. The depressed area legislation was passed by this Congress to encourage business expansion and growth in these areas of substantial and persistent underemployment. This carries with it a price tag of roughly half a billion dollars. These are only immediate and temporary measures to try to eradicate this problem.

While a tax credit as suggested in this bill would be a long-term answer to these problems, this method of encouraging business expansion has been termed by some as a windfall to some industries and a loss of revenue to the Treasury, unbalancing the budget. Call it what you will it does no more to unbalance the budget than the \$0.6 billion for public works and the \$0.5 billion for area redevelopment. But the important feature that seems to be overlooked is that by this tax credit incentive new business would be created, existing business would be encouraged to expand thereby providing new jobs, enhancing the economy on a long-term basis. I repeat, Mr. Chairman, on a long-term permanent basis not just a temporary shot in the arm manner to boost the economy for the time being.

If this country is to continue to compete favorably with the Common Market and other free nations in the field of international trade, industry, and business must have better tax incentives to expand and promote growth and production. Because our standard of living is so much higher than that in the Common Market countries, we cannot hope to compete unless we do grant more tax incentives.

This House will soon be considering legislation to beef up the unemployment compensation payments and to make permanent the increase in payments we granted last year. This will add to the expense of industry, add to their tax burden and further burden the national budget. It is far better to grant tax relief to provide additional jobs and to get the unemployed off the relief and welfare rolls than to continue to spend money for their assistance while unemployed.

In my humble opinion, there would be no loss in revenue to the Treasury by granting such a tax incentive because the demand for new equipment, the expansion of business would create enough new jobs to more than offset the loss of revenue from the tax credit. In addition thereto, we would save the money spent on area redevelopment, short-term public works projects, and increased unemployment benefits.

The Sixth District of Ohio is one of the depressed areas of this country. Six out of the nine counties have been officially designated as such by the Department of Commerce. Many of the areas have their overall economic development programs approved and are proceeding with specific projects, yet no appreciable change has been made in the rate of unemployment.

However, the Norfolk & Western Railway is in the process of developing a great industrial park in Scioto County. The Norfolk & Western is spending their money to acquire this site because of their faith in the future of this area. The land acquisition alone amounts to approximately \$1 million. This tax credit incentive will enable diversified industry to expand and locate on this site. It will create new permanent jobs for the people of this depressed area, thereby taking them off the relief rolls and relieving the State and Federal Governments of this financial burden. It will certainly expand our economic growth and add materially to our gross national product. But, above all, it will be a permanent, lasting addition to our economy via the free enterprise system without intervention of the Federal Government. And, in the long run, mean more to the people of this country than any other single action this Congress could take.

I would earnestly urge my colleagues, with the sincerest conviction, that should this tax credit proviso be deleted from the bill today that it be included at a later date in an appropriate measure. I feel that it will go a long way to answering the problem of the Common Market and expanding our own growth and economy.

I regret that I am going to have to vote for the motion to recommit with instructions, because I am violently opposed to a withholding tax on dividends and interest and this will have the effect of voting down also this tax credit incentive, yet I strongly favor it. That is why I said to you earlier that I am in a difficult position, but rest assured I believe such an incentive should be in the law to encourage new business and industrial expansion.

Mr. BAKER. Mr. Chairman, I yield such time as he may consume to the gentleman from Minnesota [Mr. LANGEN].

(Mr. LANGEN asked and was given permission to revise and extend his remarks.)

Mr. LANGEN. Mr. Chairman, it is rather unique that we have before us today a major tax bill that proposes absolutely no increase in revenue. This is particularly unique when you consider the financial plight of this nation.

We have already increased the temporary debt limit by \$2 billion and will be asked to increase it by another \$8 billion before this session ends. About 10 percent of our national budget is spent in just paying the interest on this staggering debt.

It is argued that the compromises have leveled the inequities of the original package; that no longer does the bill represent a loss of revenue. I wonder. Some of the revenue-producing provisions of the bill will not take effect until later years, so the prospect for fiscal 1963 is to unbalance the budget by perhaps several hundred million dollars.

Then, just what is this tax proposal, and what does it propose to accomplish? First of all, it contains a dozen different tax changes, none really related to the others. We are asked to vote "yes" or "no," with no change to consider each unrelated feature on its own merit. I consider this a poor way to legislate.

Even if this tax package corrected a host of glaring inequities, there might be some reason for considering it. But it does not. It opens as many new loopholes as it closes. And in my opinion, these are discriminatory loopholes.

The Revenue Act of 1962 does absolutely nothing except shift the tax burden from one group to another; a basic shift from big business to the individual.

The bill attempts to give consideration to large corporations as an incentive to expand and improve. I have yet to hear any enthusiastic utterings from either big business or labor. In fact, a relatively small group of the largest corporations will really benefit from this windfall, to the disadvantage of smaller industries and the individual taxpayer.

I certainly recognize the need to speed the economic growth of this Nation by encouraging investment in plant and equipment. I have seen proposals, however, that I feel would go much further toward meeting this objective. But here we are today, forced to consider this whole hodgepodge tax package, including the provisions for business incentive, on a take it or leave it basis. The American public deserves a bit more consideration than this.

We all know that you cannot create bonanzas for big business and still balance the ledger without penalizing some other group. This country has a ready scapegoat, the little man who needs every dollar he can lay his hands on. Take the withholding feature on interest and dividend income as an example. Even with the paupers oath exemption in the compromise, we force a great many people to live on 20 percent less income for a whole year before they can be eligible

for refunds. And I fail to see that the resulting muddle of overwithholding is going to be eliminated in practice.

Sometimes I wonder what our people back home think when they finally realize what their Congress is doing. They certainly realize this shift of the tax burden is not in favor of the individual and is not in the interest of balancing future budgets. They certainly must come to the conclusion that their Government must seriously distrust the man on the street by the implication that he uses every conceivable loophole to avoid paying his just taxes. One of these days he is going to wonder just who owns this country. And when he exerts the privileges of his rightful ownership, we may find the distrust on the other foot.

Not all of the features of this bill are bad. But enough of them are bad to make the whole package objectionable, especially when we are not allowed to work our will on it. With the increase in the debt limit facing us, I see no merit in a measure that does nothing to raise revenues. Even if this bill corrected inequities, it might be good. But it does not. It merely shifts the tax burden from one group to another, creating more inequities than it solves.

To say that I have serious reservations about this piecemeal tax package is the understatement of the session. I am sure many other Members have similar reservations. It is unfortunate that the taxpayers of our Nation must lose once more by the refusal of this body to allow their elected representatives the privilege of considering more responsible alternatives.

Mr. BAKER. Mr. Chairman, I yield such time as he may consume to the gentleman from New York [Mr. DEROUNIAN].

(Mr. DEROUNIAN asked and was given permission to revise and extend his remarks.)

Mr. DEROUNIAN. Mr. Chairman, the bill that is before you today is a hodgepodge of lures, a hodgepodge of conflicts. Various little expedients, enticements, and panaceas have been put into the bill in hasty fashion right and left to lure a vote here and a vote there in a desperate effort to get this unwise tax package passed and over to the Senate.

The administration which wants to move this bill is promising almost all things to all men to get your votes on this floor knowing perfectly well that once you have sent it to the other body you will have lost complete control of it. Those of you who are planning to vote for the bill because of any of these scattered panaceas or because of some particular provision for which you may have a great enthusiasm are certainly risking great disillusionment.

This is particularly true for the big cureall. Those of you who have some special reasons, good or bad, for favoring the investment credit need not expect to find it continued in effect very long if it ever is enacted into law. I predict that if the investment credit becomes operative the consequent revenue loss will be

such as to cause Treasury to urge its repeal more urgently than it advocated its enactment.

I think most of you know in your souls that the investment credit is a subsidy which the business community of the United States does not want and that if enacted it is just a temporary pork barrel subsidy, mostly going to big business. Big business may accept the sop handed to it on a silver platter and will not make one additional dime of equipment expenditure other than that which it would make anyway. If the investment credit were the only subject before you it could not muster a majority vote on the floor of this House. It is just that bad.

But those who will vote for this credit will be augmented by the splinter votes of those of you who find some little allure here and there in other provisions of the bill in some of the hastily added, but temporary, panaceas.

Some of these splinter votes, for example, will be the votes of persons who did support the administration's efforts to put increased taxes on mutual savings banks, building and loan associations, et cetera. Just to get the bill reported out of the Ways and Means Committee, the tough administrations proposals had to be severely watered down. Many of you who did not like the original tax proposals for these banking institutions will no doubt vote for the bill on the basis that you had better play safe and accept the watered down tax provisions.

But the impact of section 8 on these institutions was only watered down to make this part of the bill palatable on the floor of this House. Once the House passes this bill with these provisions in it we risk not recognizing them when they may return to us with the full administration proposals restored. This will be at a time when we will have little or no effective control over any provisions of the bill.

Some more splinter votes are produced by the truly phony, but temporary, panaceas which were hastily put in to make the withholding tax provisions less unpalatable. Notice I did not say "more palatable."

These panaceas are entirely illusory. One of them is the exemption certificate for children, another is the exemption certificate for those persons who can swear they will owe no income tax at all, and another panacea is the so-called quickie quarterly refund for small taxpayers.

If you have taken time to read these provisions of the bill containing these panaceas you will be shocked at their complexity and amazed that any reasonable person would think the millions of lower income people they are supposed to benefit could make use of them.

But they are put in, and very deliberately, with the thought of soliciting a few more votes on the House floor to help get a majority for this bill. And you have been and will be given all sorts of sweet cliches about how sweeping and effective these panaceas are. But, mark my words, the passage of these withholding provisions in the House bill are just

the beginning. The Treasury will be back seeking more stringent rules. We will then have no practical say about the ground rules we established in these temporary items that procured your vote to send the bill to the Senate. The proposed rules will not work and the Treasury will need more stringent rules to replace those it is now willing to accept.

When some of the supporters of this bill tell you with vigor that the withholding tax exemption certificate and refund provisions are very simple and work very easily, ask them about the 98 percent of the 30 million voters who will wear the hair shirt of the withholding tax who cannot possibly use the exemption provisions.

And, also, when they tell you such things—as I am sure they will—ask them this: If that is so, why did the administration repeatedly oppose exemption certificates on the ground that they would be unworkable and too complex? This is spread throughout Treasury testimony of the printed Ways and Means hearings; it is there for you to read. Pleasant words today on this floor cannot erase or obliterate those printed facts.

Many of you are disturbed about the provisions of the bill which put crushing and destructive penalties on U.S. business overseas and I refer to such sections as section 11, section 13, section 15, and section 16. But many of you cannot possibly understand them as written because of their technical complexity. As a result many of you are being lulled into voting for this bill by sweeping cliches by administration spokesmen to the effect that all these sections do is dispose of the problem of those little old sham, phony paper foreign corporations, or those nasty Americans who do some tax chiseling abroad, and also some mumbo-jumbo about the balance of payments, plus pontifications about equality, equity, and neutrality. None of these party line approaches that are being fed to you by every possible medium tell you the real truth.

These are commerce control clauses, not revenue legislation. These provisions are being inflicted on all American overseas businesses of every kind, every single company that flies the American flag through American voting control. Included in their sweep are not only the small fraction of 1 percent of the tax dodgers but the entire group—100 percent—of American controlled overseas companies. Every single company. All honest businesses are lumped in with the tax fraud artists and treated at the fraud level.

Not revealed to you by all the cliches and sweeping broadsides that have been aimed at you is the fact that these provisions are very carefully tailored to cut the throat of U.S. business overseas and to turn their overseas markets over to foreign-owned companies.

Do not take my word for this, just read the bill. I think everyone of you owes a duty to his country, before you vote for this bill, to read the two minority reports which discuss these sec-

tions. They are true and they are factual and, because of space limitations, even they do not disclose the entire horror picture of these provisions of the bill.

For years without number every administration has encouraged American business to go overseas, to carry the flag and build up the rest of the world. For years without number every administration, except this one, has cheered for U.S. oversea business. Yet one section of the bill is carefully contrived to punish American oversea business for having gone overseas, and to punish it retroactively all the way back to March 1, 1913. March 1, 1913 is the date the U.S. income tax was first imposed.

The section is section 16 and if you do not believe it is retroactive all the way back to March 1, 1913, read for yourself its true effective date. Just read line 13 of page 161. Just pick up your bill and read the words "after February 28, 1913."

Do you know that under the provisions of section 13 of this bill American individuals who have committed the crime of being controlling stockholders of a good, honest business corporation which in England pays a 53-percent British income tax, will be taxed currently on the earnings of that British corporation at the individual income tax rates, and those rates, as you know, go as high as 91 percent. This is to be done even though British income tax on that British company's earnings has been paid at the British 53-percent rate. Even though this bill would tax these stockholders as high as 91 percent, it also denies them the right to take a foreign tax credit for the 53-percent British income tax paid. This is not taxation; this is confiscation. And I am not talking about tax dodgers. I am talking about sturdy, honest American businessmen.

This section 13 does do this and no administration spokesman can deny it. Does party loyalty require that you vote and cheer for this?

Do you know—it is on the public records—that one of the principal supporting reasons Secretary Dillon gave the Ways and Means Committee for the provisions of this bill which are deliberately intended to destroy and cripple U.S. oversea companies is this shocker; that he wants this done in order to please the finance ministers of the six European Common Market countries?

They want to get the American-owned companies out of their countries and Mr. Dillon wants to help them do this—and this is the weapon for doing it. Do not take my word for it; read page 33 of the Secretary's printed testimony to the Ways and Means Committee.

But I have not heard of a single one of these European foreign ministers proposing that the companies of his own country be treated this way. They preach "Yankee, go home" and the Secretary agrees and this is his weapon to make the Yankee businessman come home.

Who are you going to vote for: the American businessman or the European finance ministers? This issue is just that raw.

You have the amazing situation on this floor today that many of the sections of this bill, if voted on individually, would be voted down. Put together in a package with the panaceas and lures of the kind I have mentioned they are expected collectively to cook up enough votes to send this bill to the Senate. And I must repeat, then you will find the lures and panaceas removed. What many of you want will have disappeared—only the pain will remain. But it will be too late because your vote will have been used to move this bill this week.

How many of you have any real stomach for voting to put the hair shirt of withholding taxes on 30 million American voters in order to finance a cockeyed administration economic gadget which would feed a lot of pork barrel money into big business. How popular are you going to be at home when the truth of this seeps back to your constituents?

It will be a lame excuse to try to describe to constituents the last-minute razzle-dazzle in the Ways and Means Committee which was used to set up a smokescreen to the effect that the investment credit really would not cost anything at all that was noticeable. If it were going to cause the great administrative revolution that its proponents claim, it would have to be expensive. It is still expensive, but you are being fed a party line in every administration speech on this floor that it will do great things at just about zero cost. It is amazing how little regard some people have for the intellectual acuteness of Members of this body.

What is at stake in this bill is a lot more than party loyalty. Basically, the public welfare is at stake. The only driving reason to pass this bill in this House is to save the faces of the administration, the Treasury and of some American colleges at the expense of the public welfare.

In conclusion, I want to remind you that even the national honor is at stake in this bill. A number of provisions of this bill directly violate a great many tax treaties to which the United States is a party. When we signed these treaties we pledged our national honor to respect them. But section 21 of the bill as a two-line unilateral legislative fiat nullifies these treaties. Again, do not take my word, read section 21. And do not let anyone tell you it is meaningless and just affects one little old clause in one little old treaty. Read the minority report for the true full facts.

I think the basic issue for everyone of you in this bill is whether you wish to save the national interest by voting down the bill or wish to decide that party loyalty and saving the administration face is more important than the public welfare. The issue is that blunt and that brutal.

Mr. BAKER. Mr. Chairman, I yield such time as he may consume to the gentleman from Michigan [Mr. CHAMBERLAIN].

(Mr. CHAMBERLAIN asked and was given permission to revise and extend his remarks.)

Mr. CHAMBERLAIN. Mr. Chairman, I am disappointed in this bill. Ever since I came to the Congress I have been hearing talk of major tax reform, but we never get around to doing anything. As one who has consistently advocated the reduction or repeal of our discriminatory excise taxes, I want to take this opportunity to call attention again to the fact that the 10-percent tax imposed during the Korean war to discourage automobile production is still on the books although almost every other excise tax has been reduced or repealed. I regret that our Ways and Means Committee has not seen fit to rectify this inequity and that they see nothing wrong with imposing a 10-percent excise tax on one class of manufacturing and not so taxing other manufacturing. As I have urged for the past 6 years, the time for tax reform in this area is long overdue.

Another inequity the committee has ignored in reporting this bill is the fact that the personal exemption has remained unchanged since 1948 and that inflation during this period has in effect reduced the tax benefit of this exemption. We have shown considerable concern about the adjustment of the salaries of Federal employees to compensate for the periodic increases in cost of living. Why should we likewise not be concerned over maintaining the dollar value of the personal exemption for our Nation's taxpayers? According to my own rough computations, we should raise the personal exemption to more than \$750 today to maintain the same relative tax advantage accorded the taxpayer in 1948 when the \$600 figure was enacted. I regret we have not yet found time to get about the much needed job of major tax revision.

Mr. Chairman, for the reasons that have been brought out in this debate, I intend to support the motion to recommit this bill.

Mr. BAKER. Mr. Chairman, I yield 5 minutes to the gentleman from Missouri [Mr. HALL].

(Mr. HALL asked and was given permission to revise and extend his remarks.)

Mr. HALL. Mr. Chairman, I would like to qualify on the basis of the proposer of two additional tax revision bills which I still think would be excellent legislation; and as a taxpayer-doctor I cannot support this bill in its present form for many reasons involving the district from which I come, and the people I represent. But I would like to address myself to three, primarily.

Unfortunately the trend in Washington seems to be, not to simplify our tax laws, but to make them increasingly difficult to understand. Instead of recognizing that we ought to start again—from scratch—and make our tax laws simple and understandable to those who must pay taxes; over the years the Congress has relied instead on patchwork legislation, amending previous laws, eliminating old loopholes, and sometimes creating new loopholes in the process.

The end result has been a bureaucratic nightmare, so involved and so detailed that the responsibility for determining

tax liability is less and less in the hands of our elected officials, and more and more in the hands of nameless clerks in the Office of Internal Revenue, who implement the law and write regulations. Sometimes they twist the original legislative intent.

I regret to say that the legislation being considered this week on the floor of the House falls into this category. New complex regulations are being piled on top of old complex regulations so that the end result will resemble a patchwork quilt understandable only to the most competent tax accountants, and subject to different interpretation even among them. A year ago the President indicated that he would authorize a study of our tax laws in order to form a basis for overall and comprehensive tax revision.

This has not come to pass, and the legislation before the House this week is, at best, a temporary expedient, which does not begin to touch upon our real problems in the field of taxation.

Secondly, the foreign provisions of the proposed Revenue Act of 1962, hastily and ill conceived, are based on four false assumptions.

First is that because a U.S. corporation owns over 50 percent of the voting stock of a foreign corporation, the former can cause the latter to do what the executive branch of the U.S. Government presently believes these foreign corporations should do. This ignores the corporate laws of foreign countries, the concessions and permits granted by foreign governments for such ownership, the minority stockholders in such corporations, the economic well-being of the foreign corporations and the economic and political interests of the countries in which they are located, and the customs and traditions of those countries. To be successful and endure, a foreign corporation, regardless of stock ownership, must conduct itself in the economic interest of the country of incorporation, not in the interest of the U.S. Internal Revenue Service or in accordance with what some members of the present administration of the U.S. Government think it should do.

Secondly, probably recognizing point one, the executive branch of the U.S. Government says, "So what, you'll be taxed anyway." There are already too many provisions of the present revenue code that tax on the basis of constructive receipt of income instead of actual. The proposed bill is a further and major step in that direction. This is a vicious doctrine. Regardless of how well tax bills are written, they cannot be made exact quantitative formulas in the matters in question. This leaves in the hands of the thousands of agents of the Internal Revenue Service the arbitrary power, with only lengthy and costly recourse, to determine matters of great importance and in effect dictate how foreign business should operate.

Thirdly, contrary to the protestations of the Treasury Department, the long-term effect of the foreign provisions of the bill would be to:

First. Reduce U.S. tax revenues. A great part of the new taxes imposed by the bill would be taxed by the foreign

countries in which U.S. subsidiaries operate, and revenue now received by U.S. industry from foreign subsidiaries would be dried up by the advantages given foreign competition.

Second. The present foreign business of U.S. firms would be hampered to the point that they would probably have to cease operations and their business would be surrendered to foreign companies.

Third. U.S. exports would suffer by reason of the fact that a large part of exports from the United States is made to foreign subsidiaries. As a corollary, employment in the States would suffer.

Fourth. The position of the United States with respect to the balance of payments would suffer from a drying up of royalty, dividend and other income from abroad and what would undoubtedly follow is a flight of foreign capital from the stock of U.S. companies by reason of the more favorable position of foreign companies in overseas markets.

Finally, or fourth, the foreign provisions of the proposed tax bill are inconsistent with the administration policy, with which I fully concur, as expressed in H.R. 9900 with respect to foreign trade. The results of the application of the tax bill would hinder rather than encourage foreign trade. Here is an excellent example of the right hand of government not knowing, or at least not caring, what the left is doing. The foreign tax provisions are well calculated to alienate allied nations and lose friendship in others.

Third. I believe it totally fails to accomplish its avowed purpose—the stepping up of incentives in order to create new jobs. Thus far the only real progress in putting men back to work since a year ago January has taken place in two fields. First, we have added almost 100,000 employees on the Federal payroll; and second, we have called up approximately 155,000 reservists. The former method is indefensible and the latter method hardly can be considered a solution to problems of unemployment, nor is it likely to result in an increase in our gross national product.

Reliance on an investment-credit rather than on an accelerated depreciation allowance means that we are unwilling to listen to businessmen on questions involving business.

A basic fundamental of tax legislation would seem to be that it not be discriminatory. Yet the use of investment credits is discrimination at its worst. Firms which have expanded on their own without tax inducements, will be penalized in favor of their competitors who by sitting tight, will now receive a tax windfall for their delay.

The use of an investment credit would have very limited if any effect on the retail and service industries, and in our changing economy these industries have been providing a larger and larger share of job opportunities.

On the other hand the United States ranks among the very lowest countries in the world in its allowances for depreciation. One reason that our overseas competitors have made such rapid

inroads in American markets is that they have the advantage of being able to write off obsolete equipment at a faster rate than their American counterparts. Combine this easier depreciation schedule with our foreign-aid dollars, and a lower wage rate, and it is not difficult to see why we are being caught in a competitive spider web.

Still another aspect of H.R. 10650 to which I strenuously object is the provision to institute a 20 percent withholding tax on dividends and interest.

Here we are not getting at the wealthy stockholder or the millionaire. His stockholdings are such that he would not dare to evade his taxes. We are instead reaching the widows, the retirees and those who have small but important savings in banks, in savings and loan institutions, and in stocks, others are thrifty or frugal enough (still to be encouraged in the United States of America) hoping to have put a fund in interest-bearing trusts, not Federal bonds, for their children's education. There are literally hundreds of thousands of these people with limited incomes. A great many of them are over 65 years of age.

In most instances a 20 percent withholding tax is far more than they ultimately are required to pay. These are the people least able to hire accountants or attorneys to handle the maze of paperwork that would allow them to be exempt from its provisions. They have a difficult enough time filing one tax report a year, let alone trying to keep up with quarterly refunds. There are many such retired persons in the Ozarks, and may their tribe increase.

These are the people we are threatening with a new bureaucratic nightmare. I submit that the great majority of these people are honest, they do pay their taxes, it is not necessary to send a swarm of internal revenue agents to harass them as was done recently in the town of Fordyce, Ark.—see CONGRESSIONAL RECORD, March 28, 1962, page A2411.

These are the same people for whom the costs of food, of shelter, of housing, of medical care, pose a special problem. I will not be a party to any bill which adds to that problem and therefore I will not support H.R. 10650 in its present form.

Mr. BAKER. Mr. Chairman, I yield such time as he may require to the gentleman from New Jersey [Mr. WALLHAUSER].

Mr. WALLHAUSER. Mr. Chairman, the Revenue Act of 1962, in my opinion, will not accomplish either one of the purposes of a revenue act, which in the first place would seem to be to raise revenue, or in the second place should be designed to stimulate the economy and produce more income for the citizens of the United States, but actually its passage could well have the contrary effect.

The investment credit proposal, which apparently has not been demanded by the main beneficiaries, will provide an unlooked for windfall to a relatively small group. If we were assisting the individual, or if we were rewarding, in a definite and proven way, industry for providing more jobs, one could find no great fault with this effort, but my opin-

ion is that this will not bring about the desired result. The tax on savings institutions could well hurt the housing industry and the financing of homes which is so important in the economy of this Nation, and the withholding on interest and dividends will produce massive over-withholding to the disadvantage of untold numbers of people and prove to be a costly and unnecessary headache for those whose duty it would be to administer this section of the act.

In general, there are so many features of this legislation that could be classed as either unnecessary or unfair, that I have come to the conclusion that I will have to vote against this legislation in its present form.

Mr. BAKER. Mr. Chairman, I yield 5 minutes to the gentleman from Montana [Mr. BATTIN].

(Mr. BATTIN asked and was given permission to revise and extend his remarks.)

Mr. BATTIN. Mr. Chairman, I appreciate the time of the Committee and have some questions and observations concerning the tax bill. The debate so far follows along the lines dealing primarily with the question of withholding on interest and dividends. I would like to ask the gentleman from Wisconsin if it is not true under the present law, that any person who files a fraudulent tax return, that is, leaving out part of his or her income which is derived from any source, is subject to imprisonment in a Federal penitentiary?

Mr. BYRNES of Wisconsin. Of course, if a person files a fraudulent return and it is proved to be a fraudulent return that person would be subject to a criminal penalty, the gentleman is absolutely right.

Mr. BATTIN. It would seem to me then, following the law that we presently have on the statute books, it is not so much a question of people not paying their taxes, but it is a question of failing to enforce the present laws. Therefore, the statements made today are an indictment of a great many people in this country. To say on this floor there are a lot of dishonest people in the United States who do not believe in paying their share of the taxes, and that is what has been said here, is far from the truth.

I would prefer to think, and I certainly believe that a great percentage of the people in this country are honest and they do pay their fair share of the taxes. The figures that are pulled out of the air, for example, a loss in taxes of \$850 million from interest on income, is just a figure. Nobody has taken this floor during the 2 days of debate and given any legitimate figure and information as to where they get a tax loss figure of \$850 million, or what this new bill would bring in. To bring in legislation just for the sake of trying to bring a bill before the House for consideration that does not do equity to the people involved, as the gentleman from Virginia [Mr. HARRISON] says, to the young widows who are not paying their tax is to me an indictment of a great many people, literally hundreds of people who have written to every Member of this Congress saying that they are living off of income that

they receive from interest and dividends and to penalize them because we are not enforcing the present laws of this country seems to me to be a rather shabby way to treat the taxpayers of this country.

Mr. BAKER. Mr. Chairman, will the gentleman yield?

Mr. BATTIN. I yield to the gentleman from Tennessee.

Mr. BAKER. I compliment the gentleman on his observation, and his excellent remarks. You are absolutely correct. I think more than 90 percent of these taxpayers would pay their tax if they were properly informed and they would include the interest and dividends in their gross income.

The criminal sections apply equally to that part.

Mr. BATTIN. I thank the gentleman.

Mr. GEORGE P. MILLER. Mr. Chairman, I make the point of order that a quorum is not present.

The CHAIRMAN. The Chair will count. Fifty Members are present, not a quorum. The Clerk will call the roll.

The Clerk called the roll and the following Members failed to answer to their names:

[Roll No. 50]

Andrews	Fogarty	Roberts, Ala.
Barrett	Gray	Selden
Bates	Hébert	Shelley
Bennett, Mich.	Hoffman, Mich.	Sheppard
Brooks	Holifield	Short
Carey	Johnson, Wis.	Smith, Miss.
Clancy	Jones, Ala.	Spence
Colmer	Kearns	Teague, Tex.
Curtis, Mass.	Latta	Tollefson
Davis, Tenn.	Moulder	Tupper
Dent	Nygaard	Walter
Dingell	Powell	Wilson, Ind.
Evins	Rains	

Accordingly the Committee rose; and the Speaker having resumed the chair, Mr. ROOSEVELT, Chairman of the Committee of the Whole House on the State of the Union, reported that that Committee, having had under consideration the bill H.R. 10650, and finding itself without a quorum, he had directed the roll to be called when 397 Members responded to their names, a quorum, and he submitted herewith the names of the absentees to be spread upon the Journal.

The Committee resumed its sitting.

Mr. MILLS. Mr. Chairman, I yield 5 minutes to the gentleman from Georgia [Mr. FLYNT].

(Mr. FLYNT asked and was given permission to revise and extend his remarks.)

Mr. FLYNT. Mr. Chairman, I support the Revenue Act of 1962 which is designated as H. R. 10650.

Like most of us when any revenue bill comes up, when any tax bill comes up, there is a normal human tendency to view it with misgivings. That was my reaction when I first began to study the bill which the Committee on Ways and Means reported to the House of Representatives.

When I first began to study this bill, I reached the conclusion that if I had drawn it, I would have made certain major changes in it to begin with. Then upon reading it further and upon reading portions of the hearings before the Committee on Ways and Means, and

upon reading the committee report which accompanied H.R. 10650, I began to see that there was good, sound, logical reasoning for nearly every single provision in this revenue act of 1962.

Time will not permit me to give any more than just a brief résumé of what this bill would do. I could not even begin to read the index in the time that I have been allowed. Therefore, the bulk of the time allotted to me today will be used to discuss two things which we understand will be contained in the motion to recommit.

I am opposed to the motion to recommit. I shall vote against the motion to recommit.

I shall vote for the bill.

Let me address brief remarks to what the bill as a whole does. First, it provides a new tax on certain potential sources of revenue which may not have been paying their fair share of taxes under the revenue laws which now exist.

Mr. Chairman, this bill provides some limitation on the deduction of entertainment expenses.

This bill provides for increased taxation of our mutual thrift institutions, mutual savings banks, and savings and loan associations.

Mr. Chairman, this bill changes the tax treatment of mutual fire and casualty companies.

Mr. Chairman, this bill changes the tax consequences with respect to the sale of depreciable property.

Mr. Chairman, this bill changes the tax treatment of the earnings of cooperatives.

With regard to those sections which provide for increased taxation of our mutual thrift institutions, mutual savings banks, and savings and loan associations, I certainly do not want to penalize those institutions which encourage thrift. At the same time, when certain of those institutions reach maturity and attain the financial stability that they no longer need the benefits which were provided under the laws which made possible their creation and their establishment, then they should realize they have reached maturity and should assume their normal share of the tax responsibility just like other taxpayers whether they are individuals or corporations.

It is both the obligation and responsibility of all businesses as well as individuals to assume the burden of taxation. This applies not only to mutual savings institutions but also to cooperatives and related membership type corporations.

Like all good citizens I am confident that they will willingly accept the provision of this bill.

It is the responsibility of every segment of the economy to pay its fair share and to assume its responsibility toward paying the taxes which must sustain and support the Treasury of the United States if we are to maintain fiscal strength and financial stability at a time when we need them perhaps more than ever in the history of our country.

Mr. Chairman, this is the first major revision of the Internal Revenue laws which has been presented to the House of Representatives during the five terms

I have served as a Member of this body. I want to take this opportunity to commend the Committee on Ways and Means, and especially the chairman of the committee, the gentleman from Arkansas [Mr. MILLS], who spoke yesterday, and the gentleman from Louisiana [Mr. Boggs], who spoke earlier today, for their very forthright statements. I want to commend them for the forthrightness and accuracy with which they have explained every single essential element of this bill which is before us today.

Let me come to a major point that I think is in the mind of each of us. It is one about which I had some concern initially, and at the time I read it and discussed it I had considerable reservation about that provision of the bill which provides for withholding of dividend payments and interest payments on certain types of accounts. When I asked these questions which came to me, as they must have come to many of you, I went to the chairman of the Committee on Ways and Means, discussed them with him item by item and question by question; and in every instance he gave me what I thought was a fair answer, a reasonable answer, which answered every question I had raised to him and which I feel answered every single question which has been raised in the many letters which I have received from constituents who reside in the district I represent.

Let me make this as clear as I can: The withholding provision does not impose a new tax on anybody. It collects no tax that would not be due in the absence of this provision. It levies no increased tax on anybody except, Mr. Chairman, those persons who for one reason or other during the years prior to now have evaded a substantial portion of tax liability on income from these sources.

Mr. WIDNALL. Mr. Chairman, will the gentleman yield?

Mr. FLYNT. I yield to the gentleman from New Jersey.

Mr. WIDNALL. Does not this withholding tax take away from the people that which they are entitled to and which the Government is not entitled to and that they will have difficulty getting it back?

Mr. FLYNT. I will say to the gentleman from New Jersey that I disagree with the premise upon which his question is based. I do not believe they have to sue the Government or the Internal Revenue Service to get back any money due them under the law as it is written, and certainly if it is not in it it can be corrected at the proper time.

All the taxpayer has to do is to file a claim for exemption at the source saying that he has reason to believe there will be no tax liability upon him, and then no taxes will be withheld from his dividends or interest. I ask the chairman of the Committee on Ways and Means if he have stated the situation correctly on that point.

Mr. MILLS. The gentleman has correctly stated the situation.

Mr. FLYNT. Furthermore, in regard to the question of withholding of taxes on dividends or interest, if there is no tax liability there is no tax withheld for the individual under 18 years of age, as I understand it, regardless of what his tax liability may be. All they have to do is file a document with the Internal Revenue Service.

There is no tax withheld on them anyway so long as the institution knows they are under 18 years of age. Normally, every taxpayer, regardless of age, regardless of their financial circumstances, if they will file a truthful statement that they have reason to believe there is no tax liability on them for the coming year, then all they have to do is to file that with the institution which would normally pay them the dividend and the interest to which they would be entitled.

Mr. BYRNES of Wisconsin. Mr. Chairman, will the gentleman yield?

Mr. FLYNT. I yield to the gentleman from Wisconsin.

Mr. BYRNES of Wisconsin. I think it has been overlooked by the chairman of the committee and by the gentleman here that these exemption certificates have to be filed every year. That is number one. And, number two, they are not filed with the Revenue Service, they are filed with anybody with whom you have an account. If you have stock in 10 different companies you have to make sure that on file with each one of those individual companies is a certificate, and you have to do that every single year.

Mr. FLYNT. I may say to the gentleman if I had accounts or stocks with 10 or more corporations or 10 or more savings institutions I should be delighted to file the necessary exemption certificate or pay the tax due.

The question has come up that some people would be penalized and that some people would suffer hardship and inconvenience by this new provision. I do not believe that to be the case. I believe that people with no tax liability will be excluded from the withholding on their dividends, savings, and savings bond interest by filing a simple exemption certificate with the payor of the dividend or interest certifying what? Certifying that he has reason to believe he will not be liable for the payment of any income tax for the year in question. For those under the age of 18 the exemption certificate can be filed whether or not the individual expects to have any tax liability.

Those who have some tax liability but less than the amount withheld will apply for a quarterly refund on a simple form supplied by the Internal Revenue Service. Refunds will in most cases be received in a month, as they are now being received by the 35 million taxpayers who have income from salaries and wages, who are already paying withholding from their salary or pay check, whether paid weekly, monthly, bimonthly or on any other basis within the calendar year.

I have been convinced that withholding is necessary, that it is in the best interest of the Treasury of the United States, and above that, Mr. Chairman, it is in the best interest of those taxpayers who year in and year out and month in and month out pay and pay willingly the necessary tax burden which is theirs.

Withholding of taxes on interest and dividend payments is essential as a matter of equity and as a matter of fiscal responsibility.

There is absolutely no reason why those who receive all or part of their income from interest and dividends should not have their taxes withheld—as wage and salary earners have been for 20 years. What is being considered is not a new or additional tax but simply a method of collecting taxes which are now owed the Government but not being paid.

In addition, the fiscal soundness of the pending bill depends heavily upon enactment of the withholding section, which is the largest single source of uncollected taxes owed: \$650 million.

Individuals would suffer no hardship and little inconvenience.

Withholding will pay for itself hundreds of times over.

The estimated administrative cost of the withholding system is \$19 million per year but \$650 million in presently evaded taxes will be collected.

Withholding is necessary. Publicity campaigns aimed at increasing the level of voluntary reporting of interest and dividend income have simply not worked, and attempted enforcement by tax return audits has been unproductive.

The alternatives are less effective and more costly. Automatic data processing—even when the system is fully in operation, which it will not be for several years—is no solution to the problem of mass nonreporting. Automatic data processing does not collect taxes. Even with a vast increase in information returns which would have to be filed by business, it would merely identify suspected tax evaders. Use of automatic data processing would have to be coupled with an increase of thousands in Internal Revenue's enforcement staff. Even then, only the largest suspected evasions could be checked. At the most this system would collect about \$200 million in evaded taxes and would cost some \$27 million.

The system will be simple and convenient for payors of interest and dividends. They will make their payment of withheld taxes to the Government in one lump sum quarterly. They will not be required to keep detailed records of individuals to whom they make dividend and interest payments. In addition, they will be permitted to retain use of the withheld taxes for certain specified periods before they are turned over to the Government—a provision which will help offset the cost of withholding.

A strong reason for including the withholding provision on income from interest and dividends is that about \$15 billion in dividends and interest were reported by individuals on tax returns

in 1959, the latest year for which complete Treasury data are available. In addition, there were about \$3.7 billion in dividends and interest that should have been reported in that year but were not. Most of this amount was subject to tax and the Treasury Department estimates that this underreporting resulted in a revenue loss of about \$800 million in taxes for the year. Withholding will result in the collection of about \$650 million of this amount and it is believed that almost all of the remaining gap will be accounted for when the automatic data processing system is fully developed.

Certainly this is a loophole which should be closed and one which can be closed by enactment of the committee bill but not by the motion to recommit.

Mr. Chairman, may I briefly discuss the investment credit provision. I am convinced, as I hope many of you will also become convinced, that if we are to successfully compete with those nations which are presently a part of the European Common Market, it is going to be necessary for us to do everything we can to make it possible for American industry to cut its production costs wherever it can. I believe this investment credit provision, coupled with a liberalized depreciation schedule, to be submitted by the Commissioner of Internal Revenue, will make it possible for American industry to compete on nearly an equal basis with its counterpart industry anywhere in the world. I believe we can successfully compete if our tax structure is realistic.

In conclusion, Mr. Chairman, let me emphasize that one of the main purposes of this investment credit provision is to create additional jobs for Americans.

Mr. Chairman, I have every confidence that this Internal Revenue Act of 1962 will be fairly enforced; that it will accomplish the purpose which the majority of the Committee on Ways and Means feel should be accomplished. I support the bill as reported by the majority of the Committee on Ways and Means.

Mr. Chairman, I shall therefore oppose the motion to recommit and on final passage I shall vote for the bill as reported.

Mr. BAKER. Mr. Chairman, I yield 10 minutes to the gentleman from Indiana [Mr. HALLECK].

Mr. HALLECK. Mr. Chairman and members of the Committee, I am sure the gentleman from Georgia [Mr. FLYNT], who just preceded me, had nothing to do with the quorum call, and I certainly had nothing to do with it. However, I am glad we do have a few more folks here. I am quite sure there is no filibuster on; at least, I hope there is not, because possibly we might as well go on and dispose of this matter this evening.

Now, I would like to say at the outset a word of commendation for those who have spoken on this very complex and difficult matter. I have listened to the debate. I just want to say that it has been constructive, thoughtful, and helpful. Divergent viewpoints have been expressed, and that is as it should be. I do

not know how much I can add to what has already been said, but I am going to try it, anyway, and possibly I can clarify the positions that some of us take.

Mr. Chairman, I have been majority leader of this House of Representatives on two different occasions, in the 80th and 83d Congresses. In the 80th Congress, Harold Knutson, of Minnesota, was chairman of the Committee on Ways and Means. In the 83d Congress Dan Reed, of New York, was chairman of the Committee on Ways and Means, as my very good and able friend, the gentleman from Arkansas [Mr. MILLS], is now chairman of the great Committee on Ways and Means. And, may I say, as I am sure he knows, that certainly for him I have only the highest respect and admiration.

So, having said as much, I think I can sincerely and truthfully say that I know something of the burdens that are carried by the majority when they bring a tax bill to the floor. That is as it should be, because they have the primary responsibility. But, by the same token, those in the minority have their obligation to try to assist as best they can in writing good tax legislation.

So, Mr. Chairman, we shall have a motion to recommit on our side that I trust will prevail. As I remember it, we had in the 80th and 83d Congresses substantial tax reductions for the American people, and we on our side were happy to write this tax reduction into law first in the 80th Congress, which, if I remember correctly, was passed over a Presidential veto, and that meant, of course, that there was very substantial support for the bill on the Democratic side of the aisle.

Before I speak on the motion to recommit, I just want to refer to what has already happened. We, on our side, tried to vote down the previous question, because we felt that under the limited rule that would be applied—not an open rule but a limited rule—we could offer three amendments that could have been debated in a limited way, with each being considered on its own merits. Our effort against the previous question did not prevail, so the vote came on the rule. It is a matter of record that while I supported the opposition to the previous question in order to try to amend the rule, I voted for the rule in order to bring this matter to the floor, because I realized that we still had the privilege of offering a motion to recommit and that the vote on the rule was in reality simply the beginning of the legislative process that I think we should carry on.

Now, as to the motion to recommit. There were some references made in the debate yesterday to what some called Republican irresponsibility. Well, as I view this motion to recommit, there is nothing irresponsible about it. I might say if one wanted to kick these charges around one might say that perhaps there is something a little irresponsible in a bill here presented by the committee that in my considered judgment is not a balanced bill, but one which would result in several hundreds of millions of dollars lost in revenue. I do not know how responsible it is to bring in here

what is called a tax investment credit. The strangest thing about it all is that so far as I can discover the great majority of the business people who are supposed to be the beneficiaries of this action are against it. I might say that this business of what is referred to as withholding of interest and dividends, now made in my opinion unworkable and administratively impossible, results in, I am quite sure, without regard to what anyone might say about filing notification, not in withholding of amounts due, but overwithholding of income needed by millions of people in this country living on dividends and interest.

The motion to recommit is simple and understandable. First of all, in its general effect it will remove any adverse revenue implications that exist in the committee bill. I say that because it will add in my opinion probably \$500 million in revenue in the coming year to the already hard-pressed Treasury of the United States. It will eliminate what I believe is an unwarranted subsidy or windfall for certain business interests of the country under the tax credit. There has been some talk about how we Republicans just do not want people to have jobs. Well, first of all, as to who wants this tax credit, we have a chamber of commerce in the State of Indiana. I would say on the whole it is composed of smaller businessmen. There are some larger ones in the organization. But here is what they have just sent to me with respect to the investment credit provision:

It was the recommendation of a majority of the committee that this proposal not be approved by the Congress for the reason that it had many of the characteristics of an outright subsidy and discriminated against businesses that had gone ahead with expansion and modernization of plants in previous years. The committee majority was of the opinion that a general revision in depreciation schedules and overall tax reform would serve as a greater and more lasting stimulus than the investment credit.

Now, that is the business side of our economy.

I have here a letter from Andrew J. Biemiller whom all of us refer to as "Andy." He served here with us, and he and I have been good friends for years. He writes for the American Federation of Labor and Congress of Industrial Organizations. One would think that the AFL-CIO would be primarily interested in jobs. If this tax credit gimmick is going to provide jobs, then why would Mr. Biemiller write to me as follows:

Although the AFL-CIO is unhappy with the investment tax credit proposal in the bill, it is far preferable to the accelerated depreciation provision which will be proposed in the motion to recommit.

Mr. Chairman, for the information of all of us—and I trust the information will get to Mr. Biemiller—there will be no arrangement for accelerated depreciation in the motion to recommit. So, if the AFL-CIO is unhappy, as they say, with the investment tax credit idea, then they must be satisfied that that arrangement is not going to provide real jobs.

Mr. Chairman, when we get ready to draw a motion to recommit—and may I

say this to some of my friends on our side of the aisle, because it is primarily a minority responsibility—there are all sorts of different ideas about what it ought to be.

Some say it ought to be a straight motion without instructions. Others say it ought to be a motion with instructions. When you get down to the business of a motion to recommit with instructions, I think every one of us ought to recognize that you cannot write complex legislation in that fashion and probably should not undertake it. I think that is one reason why the motion to recommit will not deal with this matter of accelerated depreciation.

I think I should say this, in all sincerity, too, that at this juncture of the affairs of this session of the House of Representatives, a straight motion to recommit would probably mean the end of legislation in this direction. And if that is true then the same result exactly is achieved by the vote on final passage of the bill.

Mr. Chairman, the motion to recommit will simply strike out two sections. And in connection with striking out those two sections it will help tremendously in the fiscal situation of our hard-pressed Government.

Just a further word about the so-called investment credit. As I have said, I think it is discriminatory. I do not think it is sound tax policy. After the credit is given, there still would be granted 100 percent depreciation.

Section 19, which likewise would be stricken out, as I say, refers to the withholding of interest and dividends. I say it will be overwithholding. I say that with the improved methods in the Internal Revenue Service, with a better realization on the part of the people who receive these interest and dividends that they should pay taxes on them, I cannot see any reason why we cannot move without what I say would add to the harassment of millions of taxpayers all over the country.

Mr. Chairman, let me make one other thing clear. As I said, it has been intimated in a place or two, if not openly charged, that when we move to strike out section 19, the withholding provision, that somehow or other we are for tax evasion. Nothing could be farther from the truth. No one condones tax evasion; certainly I do not. But I do not want to compound the confusion that certainly would result if this section goes into effect.

I sometimes wonder why it was put in here, except that apparently it was felt by the administration that they had at least to create the appearance of having a balanced bill, a bill that would not result in a loss of revenue. As I say, if you want to be sure that we do not have an unbalanced bill then I say to you vote for the motion to recommit.

If this bill is just the beginning, if a balanced bill is the goal, let us make sure that we do not start off with the wrong kind of a beginning. There are 21 sections in this bill. The motion to recommit would strike out two of them. I have heard it said here time and again

that this strikes out the heart of the bill; that it destroys the bill; that there is nothing left. We always hear about crippling amendments. If we adopt this motion to recommit, in my opinion, it would not strike out the heart of the bill; nothing at all like it. It does do away with two sections that in my opinion are not necessary and should not be adopted at this time.

Mr. Chairman, I certainly hope that the motion to recommit is adopted.

Mr. MILLS. Mr. Chairman, I yield 10 minutes to the gentleman from Missouri [Mr. BOLLING].

Mr. BOLLING. Mr. Chairman, it is a little difficult to get up at this hour, at a point when Members are beginning to cry for a vote; but I have had the privilege of spending about 10 years on the Joint Economic Committee, an assignment which I have taken very seriously. I have been rather fascinated by some of the discussion I have heard, particularly from the other side of the aisle.

I am sure there is no partisanship at all in the recommitment. There was no partisanship at all in the phalanx of votes which attempted to set up a unique method of considering a tax bill. One does not have to look very far back in the record to see that when the Republican Party was in the majority in the House of Representatives, it took exactly the same attitude on a tax bill under those circumstances that we who are in the majority take today. I am sure no one would deny that. That is the ordinary standard approach and the phalanx yesterday, the unanimous, I believe, Republican vote, was a sure indication that this bill was going to receive completely nonpartisan, nonpolitical consideration.

Now let us take a look at this question of recommitment. If we are talking of legislating in a constructive way; if we are talking about passing legislation in a constructive fashion, then I ask—what is constructive about a motion to recommit which offers no alternatives to the two sections, but simply strikes them out. What is constructive about saying, "No, we will not have any part of an effort to solve this fundamental problem that confronts America in dealing with the world situation"—a problem that has been studied and restudied and concerning which problem this is the first real effort to do something? And that is the question of the investment credit provision.

For years and years I have heard my friends on the Republican side talking about how we could, if we would only unleash private enterprise, more effectively compete with the Soviet Union. Then when the Democrats bring in a bill which tries to give private enterprise a more equitable situation in relation to all our friends in Western Europe, where they can write off investments much more quickly than we can in this country, then the Democrats are attacked as being in favor of a bonanza for business. What is the true inward attitude with reference to this problem? It is no secret—everybody in business knows what the real underlying reason is for being against the investment credit provision—they want more, and on more

favorable terms. This is not enough. They want a more advantageous pitch, from their point of view.

Mr. Chairman, this is the fair and above board way to meet this problem. This provides, frankly, for an incentive—frankly, it provides a subsidy to increase the amount of investment in automated machinery and the amount of investment in new and modernized equipment. When I tell you that every country in Western Europe has more favorable terms for writing off investments, it is not a myth. And it is not an exaggeration to say that with one or two exceptions the free countries of Western Europe are all experiencing greater economic growth than the United States. Certainly, we have to learn to compete more effectively. Certainly, we have to do things in the field of trade. But this is a good beginning. It is a good start. But our Republican friends on the other hand would offer us nothing as an alternative. They just say, "You are going to try to make a start, but we want nothing in this direction." That much is clear. They take a purely negative position on investment credit—no alternative—nothing—just strike it out.

The other section which they wish to strike out and about which they cry these crocodile tears and about which they tell us that in time when we get these automatic data processing machines in operation—and I know something about this and, fortunately, one of those automatic data processing installations is going into my district and I know when it is going to be set up and it is certainly going to be a number of years from now even if it is on schedule—as I was saying, this provision about which they cry these crocodile tears and say that everything will be all right when these machines get into operation should be adopted now because we need to see now, today, that this loophole is closed. There are many other loopholes and I hope when we have passed this tax bill, and it becomes law, that the great Committee on Ways and Means and this time in a more bipartisan manner will go to work to see if we cannot close a great many of the other loopholes that exist.

This business of crying for the widows and the orphans on the withholding tax provision is as phony as the thing we used to experience when we used to have the office of rent control. The big owners of apartment houses never came to see us; they always sent in to us the ones who had just one or two apartments to rent. They always came and told us what a terrible hardship they were going to experience. The people who are really fighting this withholding on interest and dividends are not the widows and the orphans misled by propaganda, because, despite the fact that they may have to file a certificate once a year, this does not represent a hardship.

If you say that some people will have more withheld than is necessary, what is the answer? That is exactly the present situation that we have when we withhold on salaries and wages; a great many people find at the end of the year that they have had too much withheld.

What is the difference between income from dividends and interest and income from wages and salaries? Why should not they be treated with complete equity?

So what I am saying in effect is that this bill takes a major step forward in a critical area of the U.S. economy, and that is to encourage investment. Mr. Khrushchev has said, and said repeatedly, that he will bury us; and when he talks about burying us he is not talking about burying us with bombs. He has said that he would bury us in what he calls peaceful economic competition. We have the opportunity in this investment credit section of the bill to strike a blow at his attempt to bury us; and in the withholding section of the bill we have a chance to bring equity to a tax structure, greater equity to a tax structure which is not as equitable as it could be.

Mr. BAKER. Mr. Chairman, I ask unanimous consent that the gentleman from New York [Mr. GOODELL], the gentleman from Wisconsin [Mr. SCHADEBERG], and the gentleman from Illinois [Mr. MICHEL] be permitted to extend their remarks on this bill at this point in the RECORD.

The CHAIRMAN. Is there objection to the request of the gentleman from Tennessee?

There was no objection.

Mr. GOODELL. Mr. Chairman, I rise in opposition to the bill.

As far as I can make out, the only people for the bill are, for some mysterious reason, in the Kennedy administration.

Top union officials opposed the investment tax credit proposal of the bill which would give companies an extra 7-percent credit for expansions meeting with Government approval. The AFL-CIO said it "would grant a major tax windfall to corporations without accomplishing its basic purpose of increasing the efficiency of American productive capacity." A survey revealed that only 1 out of 68 corporations felt the tax credit would have any significant effect on major expansion programs.

Approval of the provision is unique in the history of the Ways and Means Committee. I am amazed the committee would insist on providing a tax benefit so overwhelmingly opposed by virtually all segments of our society. The bill, by dictating what expansion is worth a tax credit, amounts to a drive to put Uncle Sam on the board of directors of every company in America.

The bill also provides for the withholding of taxes on dividends and interest with a complicated procedure for exemptions thrown in at the last minute in an attempt to save the bill.

Big investors have not stirred much on this issue, but average workingmen and retired persons have been pouring an avalanche of mail into Washington against the plan.

What it amounts to is that individual taxpayers will be further harassed by the Government with special certificates, forms, filings and redtape in order to keep the money that they did not owe to the Government in the first place.

I do not think that we have to hit the average honest taxpayer over the head with a sledge hammer in order to catch up with the evaders.

The bill piles complicated new features on a tax code already beyond the comprehension of most. It is a burdensome travesty of reform.

Mr. SCHADEBERG. Mr. Chairman, I am opposed to this bill.

It seems to me that in this day in which this 87th Congress has deemed it necessary to raise the national debt limit by \$15 billion and, as is common knowledge, will be asked to raise the debt limit by another \$8 billion before the end of this 1962 fiscal year, it is highly inadvisable and irresponsible to grant a 7-percent investment windfall over and above the 100-percent writeoff business and industry by law can obtain for new equipment and fixtures. We can hardly justify this in view of the increasing attempt of this administration to reach deeper and deeper into the taxpayer's pocket for additional revenues.

In this same bill we find that the Ways and Means Committee deems it necessary to withhold taxes on interest and dividends. On the surface this appears to be reasonable, if, of course, you accept as I do not, the principle of withholding—the right of Government to take a portion of the taxpayer's—citizen's—earned dollar before he receives it, but a careful investigation of the withholding-on-dividends proposal—section 19 of the bill—reveals that this proposal will be especially harmful to our elder citizens, those this administration claims needs socialized medical care because of their unfortunate financial circumstance. Let us put this in proper perspective: Why cannot our elder citizens care for the themselves? Is it not because of inflation which has devaluated their savings? As the years pass by and our citizens approach retirement years, many of them have decreasing income. Having, with no little sacrifice on their own part, invested their small savings, we now want to withhold 20 percent of the income on their savings. This is a hardship on those who can least afford it, since those who have little income—and thus the withholding is not a sizable amount—will be placed in the position of having to claim from the Government that to which under law the Government has no legitimate right and—if made legal—no moral right. Not only will the person not have use of the money withheld—which is needed, but in many cases the individual will have to secure professional advice to recover what was withheld. He will be the victim of technicalities that will result in loss of much-needed income. We ought to be at least as interested in people as we are in their tax dollar.

The facts are that this proposal will require additional help by the Internal Revenue Department to meet the additional load of correspondence associated with the attempt of the ones whose tax on dividend was withheld to recover payment.

It is my understanding that dividends and interest over \$10 have to be reported to the Government on form 1099. It is a

simple thing to compare form 1099 against the individual income-tax returns.

Let us simplify, not further complicate, our tax structure.

Mr. MICHEL. Mr. Chairman, on April 20 of last year the President sent to Congress a message containing a series of proposals on the review of certain of the present tax laws. Included in these proposals was a recommendation that Congress correct the present inequity in the application of the tax to certain cooperatives.

The President said:

Contrary to the intention of Congress, substantial income from certain cooperative enterprises, reflecting business operations, is not being taxed either to the cooperative organization itself or its members.

The President pointed out that this inequity had resulted from court decisions which held that patronage refunds in certain forms are nontaxable. The President further recommended that the law be clarified so that all earnings are taxable either to the cooperative or to their patrons.

If my colleagues will bear with me for a few moments, I would like to review the history of the situation which led up to the recommendations of the President.

In 1951 Congress amended the Internal Revenue Code to provide that earnings of farmers' marketing and purchasing cooperatives are taxable in the hands of either the cooperatives of their patrons. Earnings distributed to patrons, in the form of cash, securities, other scrip, or book credits were to be considered taxable income of these patrons.

However, Federal appellate courts have held that some cooperative-issued securities or other scrip were of questionable value, did not in fact represent income to the patrons, and therefore were not taxable to them.

The result is that the earnings of some cooperatives have not been taxed, that is, neither the cooperative nor their patrons paid.

This situation has led to extended consideration of means whereby the objectives of the 1951 amendments could be implemented.

In 1957 the Treasury Department recommended a withholding system on noncash cooperative dividends. The Congress did not take action on this proposal.

In 1959 the Treasury proposed that Congress tax cooperatives on all earnings which are not either first, paid to patrons in cash; or second, paid to patrons in scrip redeemable within 3 years and bearing interest of at least 4 percent.

In response to the request of the President, the Ways and Means Committee conducted hearings last year and has now brought forth a bill which purports to provide for the clarification of the present law. However, in my humble opinion, I submit that the only thing which has been done by the committee and which is part of the tax reform bill before you today is to take from the patron 20 percent of something which he

does not have and turn it over to the Treasury, and it forces the cooperative to be the collection agent.

I refer to the provision of the bill which will require that the cooperative withhold at least 20 percent of the patronage dividend allocated to the patron. The real question as to whether or not the scrip certificate or allocation made by the cooperative constitutes taxable income to the patron has not been solved.

Under the 16th amendment, Congress has the power to lay and collect taxes on incomes, from whatever sources derived. The principle has long been recognized by the courts that what is not in fact income cannot be made income by legislative action or by regulations of the executive branch.

In his appearance before the Ways and Means Committee, May 3, Secretary Dillon pointed out that several court decisions have nullified the intent of the 1951 legislation and have held that a patron does not realize income on scrip having no market value. For example, in the Carpenter case—1955—the U.S. Court of Appeals for the Fifth Circuit held that the revolving fund certificates under consideration in that case did not constitute income to the patron. The court added, and I read:

It is fundamental in income taxation that before a cash basis taxpayer may be charged with the receipt of income he must receive cash or property having a fair market value, or such cash or property must be unqualifiedly subject to his demand (219 Fed. 2d 635).

In the Long Poultry Farms case—1957—the U.S. Court of Appeals for the Fourth Circuit commented as follows:

It is argued that under implied agreement arising out of the provisions of the bylaws taxpayer in effect received in cash the amount of the credit and reinvested it in the revolving fund of the cooperative; but this is simply to exalt fiction and ignore reality.

To require the inclusion in income of contingent credits, such as are here involved, would be to require the patrons of cooperatives to pay tax upon income which they have not received, over which they have been given no control and which they may never receive. Apart from the question of constitutionality of such a requirement, which would be a serious one, it is a safe assumption that Congress never intended to impose upon the patrons of cooperatives the hardship and burden which the taxability of these contingent credits would involve (249 Fed. 2d 726).

Those supporting this tax proposal reason that the patron being made aware of the new provision will have consented to this method of taxation at the time of entrance into the cooperative. I doubt seriously whether the courts will sustain this view. In my opinion, patrons will resent this effort to pass along to them a tax liability which is not correctly their responsibility. It places the Government in a position, as I indicated before, of collecting by the withholding method a tax which the patron does not owe under the interpretation of the courts. This, I feel, is an injustice to the patron and it

could have serious repercussions on the many patron members of farm cooperatives. For example, those few farmers who enjoy prosperity to the extent that their taxable income exceeds the 20-percent level, would be required to take funds from their own receipts to pay the difference in the tax as it would be assessed.

It does not seem quite right to me to make farmers or other patrons pay tax out of his own pocket when he receives no cash dividend over which he can exercise real dominion or control, and I submit that the courts could hold that he has not received any taxable income because he does not have readily realizable economic value.

Under the provisions of this bill, 20 percent of the so-called patronage dividend or allocation would be withheld by the cooperative except in certain cases, and the balance of the dividend under the bylaw-consent provision would be held by the cooperative and reinvested for an indefinite period of time and with no assurance that it would ever be paid to the patron. The only alternative for the patron in this situation would be for him to withdraw his membership from the cooperative.

If the courts sustain this point of view which I have presented to you this afternoon—and I have no doubt but what they will—the administration will be in the same untenable position it is in at the present time in regard to collecting this tax from the patrons or from the cooperatives.

I am sure my colleagues appreciate the fact that in certain areas of this country the farmer is limited in membership to a single cooperative, and he has no alternative but to join this cooperative if he wants to market his farm products. To impose this withholding tax on such a patron and force him to maintain his membership in such a cooperative appears to me to be an extremely burdensome load and could be only interpreted by the patron as the cost of membership in such an organization.

(Mr. AVERY asked and was given permission to extend his remarks at this point in the RECORD.)

[Mr. AVERY'S remarks will appear hereafter in the Appendix.]

Mr. BAKER. Mr. Chairman, I yield the balance of the time on this side to the gentleman from Wisconsin [Mr. BYRNES].

The CHAIRMAN. The gentleman from Wisconsin is recognized for 35 minutes.

Mr. BYRNES of Wisconsin. Mr. Chairman—

Mr. BELCHER. Mr. Chairman, will the gentleman yield?

Mr. BYRNES of Wisconsin. I yield.

Mr. BELCHER. In the past few minutes I have heard the gentleman from Missouri and the gentleman from Georgia trying to explain what this bill would do for business. I represent one of the fine industrial cities of the country. Not less than 200 of the businessmen of this city have written me about

this investment credit, not a single one supporting it.

I am in this position if I should vote for this bill of having to ask the gentleman from Georgia and the gentleman from Missouri to come out to my district and explain one by one to each of these fine successful businessmen in my district just exactly what they face and show how this would increase their operation or provide more jobs.

I just doubt very seriously if the gentleman from Georgia and the gentleman from Missouri would consent to come out to my State and explain this to my businessmen.

Mr. BYRNES of Wisconsin. Mr. Chairman, I am going to attempt to be just as dispassionate as I possibly can in discussing the merits of this bill and the motion to recommit. First, however, let me set the record straight. The President, I understand, at his press conference today accused the Republicans of attempting to kill the bill and all the proposals that are in it.

I think the President should either have a little better liaison as to what is happening up here or, at least, make some check before he indulges in statements like that. There is no effort to kill this bill as such. There is every effort being made to improve the bill and put it in a condition where this House can be proud to pass it. We do not want to be put in a position of passing a bill that in the future we will be embarrassed by having approved.

This bill contains 21 sections. Generally speaking, 18 of those sections are fairly well worked out and represent desirable changes. Some of the things that the President even suggested we were trying to kill today are in the 17 or 18 sections that we on our side participated in improving and encouraging adoption of. On those 18 matters all of us on the committee as individuals in a bipartisan or nonpartisan manner attempted to bring equity into the solution of the problem that exists. I will vote for the bill with all of these 18 sections, if we can eliminate the 2 items we will talk about in the motion to recommit.

Do you know what the remaining 18 sections will do for the revenue? They will add \$500 million to the fiscal position of our Government. You cannot say that is not of some significance. They talk about our trying to gut the bill and get rid of the bill completely. If our motion to recommit is adopted and this bill is passed, you will still have made some very important changes in the tax laws and you will improve the fiscal situation by \$500 million a year, instead of putting it in a deficit position, which would be the case if you adopted the bill without the motion to recommit.

There are three sections I would like to deal with and on which there is controversy. Peculiarly enough, it seems it was only when we got down to these items that they were not concerned about what the Republicans wanted to do to try to assist them. We tried to

be helpful in writing provisions that would meet the situation.

First, let us take the taxation of foreign-controlled corporations. There are other sections in this bill that close up real loopholes in this foreign field, and I am for them. I supported them wholeheartedly. There is another proposition, however, that we ended up with the last day of the session and reversed the action taken by all members of the committee on a proposition that was proposition that was presented to us by the staff of the Joint Committee on Internal Revenue to take care of the problem that exists here and really hit at the abuses. But, the whiplash came from downtown, and I am not talking necessarily about the White House. I am talking about the AFL-CIO. They said if you do not expand this we are going to have to be against your bill.

So, what happened? On a purely partisan vote they reversed what the committee did. The committee had turned down the Treasury's proposals three or four times, if I am not mistaken. But they reversed the position they had taken, as far as adopting the staff proposal was concerned, by a purely partisan vote. They said, No, we have to get into this area. We want to discourage Americans from being able to operate abroad. This is the most astounding feature of this legislation. At a moment when our Government is prepared to pour more billions into foreign aid to provide economic development for other parts of the world, the Treasury Department is asking for new restrictions which are plainly designed to reduce American industrial activity abroad.

Mr. Chairman, this is inconsistent with the statement of the President urging the stimulation of private enterprise participation in oversea economic development activity. It is inconsistent with the statement of his predecessor, Secretary Dillion, when he was urging the Committee on Ways and Means only 21 months ago to provide tax incentive measures, when he called for his deferral of income abroad by U.S. business corporations. It is inconsistent with the State Department proposal in connection with the alliance for progress. It is against the commitment that we signed as an article to the OECD, that agency on which we depend for development and assistance. It is inconsistent with the maintenance by the Commerce Department of a costly bureau devoted to finding better investments abroad for American business.

It is inconsistent with the almost 50 years of U.S. policy designed to encourage and assist American businessmen in expanding our markets and facilities overseas for the benefit of the American worker and the American investor and the American exporter and the U.S. Treasury, which benefits from the income brought back home from such enterprise; yes, and benefit the American balance of payments which result from the bringing back of funds earned abroad. It is inconsistent with the pattern established by other industrial nations of the world through their progres-

sive administrations, including this one up to now. Mr. Chairman, I refer to the pattern of encouraging and enabling our own businessmen to compete at least on equal terms with their competitors of other nationalities. This provision is inconsistent with the standard of fairness toward American businessmen which our own Government has urged to invest billions of dollars abroad to seek expanding markets. It is inconsistent with commonsense, and it is inconsistent with the national interest.

Since World War II, Mr. Chairman, our American business concerns have penetrated with great initiative and great courage into all corners of the free world—many of them areas which have historically been the exclusive preserve of European firms and cartels. They have done so in the belief, supported by the statements of every President, including the present one, that such penetration of foreign markets was in the national interest.

They have competed successfully on their own grounds abroad with such foreign industrial giants as the \$9 billion Royal Dutch Shell complex and the \$2 billion Unilever concern, both of which are of mixed British and Dutch ownership, with Volkswagen, Siemens, and Krupp of German, with Philips of Holland, Hitachi of Japan, Fiat of Italy, Imperial Chemicals, British Petroleum, and others—all companies with sales or assets in the billion-dollar class. They have faced the vigorous competition of Pirelli, Renault, and Thyssen, SKF and Petrofina, of Mitsubishi, of Mannesmann, Montecatini, and others. They have competed with them not only in their own countries but in the all-important third-country markets of the world, such as the growing markets of South America, Africa, and Middle East. They have done this without subsidy, without many of the Government helps which are available to the European and the Japanese, and without obscure banking and insurance tieins.

And they have done these things, Mr. Chairman, with honor to themselves and honor to their country. They have played by the rules, and better, they have maintained the high standards of ethics, employee and community relations, fair play, and good products and services. Today in all parts of the world the brand names of American products are popular and friendly symbols of American life.

These business ambassadors have conducted themselves so well that they have not been subjected to the taunt "Yankee go home." But if the Treasury has its mysterious way in this legislation they will hear the cry from Washington of "Yankee come home." And those who are considering investments abroad are already hearing the words, "Yankee stay home."

Now, we have had the suggestion made that if we close this up we are going to be able to provide for the exportation of jobs; that this investment means we will have no jobs for workers here and they will be going abroad. Well, this argument that this bill will provide jobs for Americans is merely a demagogic appeal which has no real basis in fact.

Now, my colleague, the gentleman from Louisiana [Mr. Boggs], who is present here, agreed with me on this point at one time, because he went over to the Senate Finance Committee in 1960 and he appeared on a bill over there which he was sponsoring. And, what did he say?

In addition to that I found that a lot of these old shibboleths that make the rounds just are not so. For instance, that investment means the export of American jobs. This is one we hear quite frequently.

In other words, it is just one of these cats under the bed. That is what the Congressman from Louisiana, the present whip of the majority, told the U.S. Senate in 1960. And, I agreed with him and I agree with him now.

Mr. BOGGS. Mr. Chairman, will the gentleman yield?

Mr. BYRNES of Wisconsin. I yield to the gentleman from Louisiana.

Mr. BOGGS. If the gentleman is so touchy about that, why did he not make it a part of his motion to recommit?

Mr. BYRNES of Wisconsin. I will be glad to go into that, because I had intended to do so before I finish. We did make that effort. We made the effort when we proposed that you give us a rule to make it possible to offer a substitute for this provision, a substitute that the committee had agreed on up to the final day.

That is what we asked you to vote for, to give us that opportunity to make that our alternative and to make that proposed substitute. You turned it down. I am not dumb enough that I am going to have to be turned down twice by the same people. As far as I am concerned, I lost that battle, but the battle will continue.

Mr. BOGGS. If the gentleman will yield, the gentleman still has the opportunity, does he not?

Mr. BYRNES of Wisconsin. I have learned what the chances of that opportunity are, and you showed us that just the other day by turning down our proposal to have a substitute rule.

Mr. Chairman, I would like to assess, though, a little bit, this argument that the U.S. oversea firms are costing Americans jobs.

Mr. BOGGS. Mr. Chairman, will the gentleman yield once more?

The gentleman referred to me.

Mr. BYRNES of Wisconsin. I thought I yielded to the gentleman. Go ahead; all right.

Mr. BOGGS. I believe it will save time, and we will yield the gentleman additional time.

The argument the gentleman advances so far as having been defeated on the third proposition, would also apply to the other propositions, would it not, since he was also defeated on his other parts of his motion to recommit.

Mr. BYRNES of Wisconsin. No, sir; just on one, not all of them.

Mr. BOGGS. If the gentleman will yield further, on his open rule proposition, the gentleman had three of them.

Mr. BYRNES of Wisconsin. I am not going to yield further, because this has nothing to do with the subject which I quoted the gentleman on.

But I would like to assess this argument that U.S. oversea firms are costing Americans jobs. In that great majority of cases American business has gone abroad because it has found it necessary to do so in order to hold or to penetrate foreign markets in order to meet foreign competition.

I might say that there are American firms abroad which do export to the United States, but most U.S. firms in the foreign lands are selling their total output in the foreign market. That was the evidence before the committee.

Let us first consider the U.S. firm abroad which exports to the United States. The fact that the foreign subsidiary is American owned is not in any real sense the cause of any loss of jobs in the United States. The economic facts of life are such that if an American-owned foreign subsidiary were not manufacturing a given product which was being exported to the United States, you can be quite sure that this same product would be manufactured abroad and exported to the United States by a foreign company. Let us not delude ourselves in the thinking that Great Britain, Western Germany, Japan, or any other industrial, advanced country does not have the economic know-how, the capital, and the will to produce quality products which can be exported and sold in the U.S. market. If American jobs are being lost by the importation of products from abroad, the problem will not be cured by putting an American-foreign subsidiary out of business and turning that business over to a foreign-owned corporation. In any specific case, if we want to protect American workmen from the competition of foreign imports the real answer is in the tariff laws and the remedy is to apply effective tariff protection against the importation of such products. This is a matter about which I am gravely concerned and it is a matter which I am sure many of us want to explore in great depth in our consideration of the proposed Trade Expansion Act of 1962.

It is, therefore, obvious that in those cases where American-owned firms are exporting to the United States, the proposed restrictions on these firms operating abroad will not themselves in any way benefit the workers in our own domestic industry. The only real effect of such restrictions will be to penalize American-owned firms abroad and turn the business over to foreign-owned companies. If under the policies of the administration we are to further lower our tariffs to the benefit of foreign imports, it is far better that at least we permit U.S. enterprises to participate in this trade through their oversea affiliate rather than to leave the market entirely to foreign-owned firms.

By far the great majority of U.S. firms operating abroad today sell their output in the foreign country where they are operating or in other foreign markets. Because of foreign tariffs, import quotas, exchange restrictions, and nationalistic laws favoring the development of local industry it is not always possible to effectively compete in these foreign markets with exports from the United States.

If Americans wish to share in these markets it is therefore necessary for them to establish oversea subsidiaries.

If the proponents of this bill prevail and crippling restrictions are placed on U.S. firms abroad then it will be no longer possible for U.S.-owned foreign subsidiaries to continue to share in these foreign markets. And if the U.S. firms are forced to retire from these markets under the "Yankee come home" philosophy, this business will then fall to the foreign competitors. Here again the result would be the surrender of world markets to foreign competitors.

Actually, rather than exporting jobs, U.S. private investment abroad provides jobs at home. These investments abroad provide a market for the export of U.S.-made machinery and equipment as well as raw materials, intermediates, components, and spare parts used in processing finished products and maintenance. On the other hand if these industries are owned and controlled by nationals of Western European or other countries it quite naturally can be assumed that they will turn to their mother countries for their equipment and raw materials. This would reduce exports from the United States, and the related U.S. jobs, to say nothing of the loss of dividends that now flow back to the United States from American-owned firms abroad to provide dividends to the shareholders of the U.S. parent companies and tax revenues to the U.S. Treasury.

Let me give you another little example of this job proposition that is talked about. I would like to quote from the Secretary of Commerce, and this is not going away back here. This was just March 16. Let me quote him in a speech he made. He said this:

U.S. investment abroad is important to our export expansion program. Direct investment in manufacturing facilities abroad stimulates our export of capital equipment. Our export of parts and raw materials and our export of finished products do fill out the lines of subsidiaries producing and selling abroad.

That is jobs here that that investment created, and the Secretary of Commerce tells you so.

Mr. Chairman, he goes further and says this:

To the extent the United States invests abroad, the financial strength and the competitive capability of American companies reinforces our domestic economy. To the extent that the earnings of these investments are returned to the United States, they make a direct contribution to improving our balance of payments.

The very thing that we keep saying we want to do.

Mr. Chairman, this bill closes the door to do it. That is why we are against it and are trying to make a correction in this bill as far as the taxation of controlled foreign corporations are concerned. We are not trying to kill the bill. We are trying to eliminate this bill which will handicap the purpose that the Secretary of Commerce has told us should be our objective. That is what we are trying to do.

Mr. Chairman, why should not Americans be able to compete abroad on an

equal basis with the German and French and British counterparts? If they reduce their foreign taxes by operating, let us say, in Switzerland, for their sales operation, who benefits? The United States benefits because when they bring that money back we insist that in toto there should have been a 52-percent tax paid. So, if they have already paid 20 percent, we assess the balance. If they have already paid 52 percent to the Germany Government or the French Government, we get nothing. Sometimes I just cannot fathom the logic of some of these proposals.

Mr. Chairman, let me talk about the subsidy to business on which the President put such great reliance for accomplishing such wonderful objectives. In fact, we are going to have no more problem with the Soviets, one would conclude from listening to the gentleman from Missouri who preceded me, because this is just going to put us so far ahead that we will not have to worry about the Soviets or the Communists or any other problems like that. But the gentleman from Missouri mentioned that he serves on the Joint Economic Committee. I wonder if the gentleman was present before that committee when Leon Keyserling, the former economic adviser to President Truman testified this year and commented on the tax credit proposal. What did he call it? To refresh the gentleman's memory, he called it a tax bonanza. I do not often agree with some of the economic philosophy of Leon Keyserling, but with this one I do.

The administration presented the proposal on the basis that we should put our depreciation law on a par with that of other countries. That has been expressed here. That is, we have got to get our depreciation laws on a par with those of some of our foreign competitors. But this does not change depreciation laws one iota. They also suggest that it is necessary to spur modernization and I am going to suggest to you that there is a very serious question whether it can do that to any degree. But what about depreciation? It is not depreciation reform, and that is what is needed, and that is what we attempted to give you when we asked for a rule which would make a depreciation reform provision eligible as a substitute for this bonanza section. But that has nothing to do with this provision here.

Under this proposal—and I hope you will follow me on this, because it is not so complicated; in fact, it is very simple, what this bill does under this proposal. A businessman goes out and buys an item and pays \$20,000 for it; let us say a machine, or something of that kind, that he uses in his business. It is depreciated. He gets a subsidy for buying that of \$1,400, or 7 percent. The Government might just as well, to all intents and purposes, write him a check at that time and say: "You send us the bill and prove that you have this item and it is in place and operating and that it has cost you \$20,000; here is your check." But we do make him wait until he files his income tax return and then instead of sending the check his return shows what he owes Uncle Sam and he can deduct \$1,400. There is not much

difference between the two. It is just that he has to wait a little longer under that system.

Now, what does the taxpayer do then? Although this equipment really cost only \$18,600—that is, \$20,000, less \$1,400—he puts the equipment on his books at \$20,000, and through depreciation he gets his \$20,000 back. In fact, what he has gotten back is \$21,600 from the Government for an investment of \$20,000 over the period of time.

To me, that is the gimmick; that is the bonanza; that is the windfall. It is not depreciation reform, because it has nothing to do with how he depreciates this item. The committee would not even permit us to say to this man at least, "Put it on your books for \$18,600," because that is all he paid for it. Oh, no, we could not do that.

What about the incentive to expand and modernize? And mark you this: this credit is given not for any increase in investment over what they are investing now, as proposed in the original Treasury suggestion. The original proposition that came from the President—yes, at least, that had that merit, that you only got the credit as you invested more than you had been investing. But not this one—not as it comes to us today. You get it for just getting what you planned to do all the time and you even get it for the fact that by happenstance the machine was put into operation in your plant after the first of this year even before the bill is passed. That is a bonanza. That is a windfall in my book. The taxpayer is going to get credit for doing just what he planned. There are some that have to expand and have to go in and make certain investments. There are certain of your utilities. There is one large utility that will get \$80 million a year for doing what it has to do to serve its customers and for doing what it intended to do, but you are going to give them a handout. They do not want it. Why? Because it disrupts their whole bookkeeping operation.

The inequities in this thing are multitudinous. I hope some of you would at least just skim through the minority report where we set out some of those inequities. But let me say this: Nobody is for this credit. The gentleman from Indiana [Mr. HALLECK] referred the letter from the AFL-CIO. I would call your attention to their statement which they issued in Florida and you can see whether it is going to stimulate business and create jobs.

I refer the Members to the statement issued by the American Federation of Labor-CIO executive council, which met at Bal Harbour, Fla., on February 23, 1962. This is pretty current, too. They knew what was in the bill. They knew what the economic situation was that we faced. But what did the executive council of this organization say?

I quote:

The AFL-CIO has strongly and vigorously opposed the investment tax credit proposal as one that would grant a major tax windfall to corporations without accomplishing its basic purpose of increasing the efficiency of American productive capacity.

Yet, we find all the great economists on the Democratic side today telling us the great wonders that are going to be produced. No, the major business organizations, the major labor organizations, in effect, say, "It stinks"—and I join them.

You have not heard much about the farmers. The farmers have something to say about this too and we finally find the American Farmers Union and the American Farm Bureau in agreement. On the other provision, we found the NAM and the AFL-CIO in agreement. Now we even find these two great farm organizations in bed together. Let me tell you what they say:

The overwhelming majority of farmers due to catastrophic low prices do not enjoy the privilege of contributing income taxes to their Government.

That is one of the items we also have in the motion to recommit to strike out. Then they go on to say:

Also urge your influence to delete provision giving huge private corporations operating at less than full capacity over \$1½ billion and private electrical power monopoly over \$100 million in tax subsidies which would result in the flight of capital overseas and further aggravate the dollar crisis.

It is signed "James G. Patton, president, National Farmers Union."

What about the American Farm Bureau? They have a longer list but they point out that they are opposed to this bill. They say:

Our major objections to this legislation are (1) to section 2, the credit for investment in certain depreciable property.

They make the following statement:

SEC. 2. Credit for investment:

The proposed investment credit is a selective form of tax relief—in reality a subsidy. This is clearly indicated by the fact that the proposed credit would be allowed as a deduction from the amount due as taxes rather than as an adjustment in the amount of income subject to tax and the fact that it would not reduce the basis of capital assets for depreciation purposes. The result would be to give some taxpayers a competitive advantage at the expense of others. Furthermore, the adoption of this special treatment for some taxpayers would postpone the day when the present burdensome level of income tax rates can be reduced for all taxpayers. It would be far better to liberalize the treatment of depreciation.

Reports indicate that a motion may be made to recommit the bill with instructions for the Ways and Means Committee to make certain changes, including the addition of an inventory investment credit. In our opinion, the proposal for an inventory credit is as objectionable as the proposed investment credit and for approximately the same reasons.

I would suggest that they in this same letter take the same position as the Farmers' Union, opposed to the withholding tax on dividends and interest. They also make this statement:

Sec. 19. Withholding tax on dividends and interest:

We are opposed in principle to the application of a withholding tax to dividends and interest.

The problems involved in applying withholding to dividends and interest are entirely different from those involved in the

withholding of taxes from wages and salaries. The application of withholding to dividends and interest inevitably would lead to confusion and inequity for individual taxpayers, to say nothing of the greatly increased paperwork that would be required of concerns responsible for withholding.

The Republicans do favor acceleration of depreciation and depreciation reform, something that business can depend on, can plan on. Let me point this out, and I think it is one of the bases for the great concern that American business has about the possible adoption of this credit. They know it cannot be anything else but temporary. There was even language when it was first submitted to us that indicated that that might have been the intention of the drafters, and then they came back and said, "No, we think that ought to be permanent." But it can only be temporary, and everybody knows it. It is just a loophole. The temporary nature of this provision will be assured as soon as the taxpayers wake up and find out who will be getting the windfall resulting from the passage of this credit, and they are going to be down here in droves, saying, "Repeal that." The businessmen know that they cannot make any plan to buy a machine that will be installed 3 years from now on the basis of this credit, because they cannot get the credit until 3 years from now when the plant is in operation, and by that time the law will probably be repealed. A true depreciation reform would be meaningful, and we could live with it. It would not be just a plain subsidy. How much will this investment credit really cost? The staff of the Joint Committee on Internal Revenue estimated \$20 billion by 1972.

Here is their estimate:

ESTIMATED REVENUE LOSS UNDER INVESTMENT CREDIT PROVISION OF H.R. 10650 AS AMENDED BY WAYS AND MEANS COMMITTEE FLOOR AMENDMENT, 1962-72, ASSUMING AN ANNUAL INCREASE OF 5 PERCENT IN INVESTMENT IN ELIGIBLE ASSETS¹

Revenue loss attributable to investment credit on assets acquired or constructed in calendar year

[Millions]			
On current revenue loss basis ²		Including deferred revenue loss ³	
Calendar year	Revenue loss	Calendar year	Revenue loss
1962.....	\$1,400	1962.....	\$1,400
1963.....	1,470	1963.....	1,500
1964.....	1,540	1964.....	1,610
1965.....	1,620	1965.....	1,730
1966.....	1,700	1966.....	1,810
1967.....	1,780	1967.....	1,900
1968.....	1,870	1968.....	2,000
1969.....	1,960	1969.....	2,100
1970.....	2,060	1970.....	2,200
1971.....	2,160	1971.....	2,310
1972.....	2,270	1972.....	2,430
1962-66 ⁴	7,710	1962-66 ⁴	8,040
1962-72 ⁴	19,820	1962-72 ⁴	20,980

¹ This is the level of increase assumed by the Secretary of the Treasury in address on Mar. 19, 1962.

² Without allowance for fact that some of the revenue savings arising out of the \$25,000 limitation will be lost in subsequent years through operation of the carry-forward provision.

³ With allowance for the assumption that 50 percent of the revenue savings arising out of the \$25,000 limitation will be lost in subsequent years through operation of the carry-forward provision.

⁴ Detail will not necessarily add to totals because of rounding.

We Republicans urged a 20-percent increase in the amount of depreciation that could be taken. We still urge that, but we are opposed to this so-called depreciation reform.

The President said in his press conference this afternoon that the tax burden should be spread equally. This handout does not spread it equally. Let me make that statement very positively. It is as inequitable as can be. How he can make that statement and then say we should support this particular proposal I cannot understand. If this proposal cannot be replaced by true depreciation reform it should be beaten; and the motion to recommit will so provide. If it is stricken out then the committee can move on—and I am talking about the Ways and Means Committee—move on to the consideration of true depreciation reform.

Now let me talk to the third item that we object to, and that is the matter of withholding on dividends and interest. We are told that this is simple. I state to you in all sincerity I am absolutely convinced that this provision is going to create a nightmare of redtape for those who have interest income or any dividend income or who have any connection with the paying of interest and dividends. It cannot help but do it. There are 350 million savings and shareholder accounts in this country, accounts where the dividend and interest amount to over \$10. I suppose that today's interest will approach \$250 but look at all the accounts below that. They are not taken into consideration in this \$350 million. So you can add hundreds of millions more. It does not take into account either the patrons of cooperatives who have their accounts; it does not take care of policyholders in insurance companies and payments of interest and additions to policies they hold. A modest estimate is at least 500 million accounts that will be subject to filing an exemption certificate. Some will not file and then there will be overwithholding on many of them.

Let me tell you something about this exemption certificate on which the chairman placed so much reliance to the extent that he has now made it into a fair proposition.

It is peculiar that the Treasury Department in our executive session when we were considering this matter said, "Oh, you cannot do that because that will make it unworkable." They said we might apply it limitedly for a while to those over 65, but they recognized at that time that you cannot exempt all of these people, all of these accounts. You would make an impossible situation for us, they said.

The committee removed the exemption. Then they came back and gave it to everyone. I suppose if we had some more time, if this bill was not up today, we would have another session of the committee and we might even have a change in the investment credit feature, because we have had a change there since we reported the bill out last week.

There is no matching of any records of the payer corporation or company with what the taxpayer's records show

or what he says as to how much has been withheld. There is no attempt to balance them or match them and see that it is properly enforced. Also, I do not know where the gentleman gets the idea that we are going to have a revolution in the Revenue Service, that if you apply for a refund you will get it back in 2 or 3 weeks. The American people will be glad to learn of this miracle that is coming about. If they have to process all of these certificates and applications for refunds we are going to be waiting a long time to get that done.

There is nothing in this to assure us that you are going to have any more accurate reports of dividends or interest received, there is nothing in here to assure that people will not file for a refund who are not entitled to it, because there is no way to determine it. They do not match them up today.

We say they can be matched today. That they can match the reports that are filed by banks and by corporations with the Internal Revenue Service, and they can do a better job of enforcement and use this effort that we made in the last 2 years to encourage a better compliance. I am not suggesting, and nobody on this side suggests, that people should get by without paying their legitimate tax, but we do say we should not get our administrative machinery so overburdened with redtape that we will make our whole tax system look ridiculous and the voluntary compliance part of it fall down.

Mr. Chairman, I wrote people in my district who communicated with me a year or so ago when we were working on this subject. They wrote me they thought the withholding of dividends and interest was a bad thing. I wrote them and said that if a feasible and administrative way can be found, and that is what the committee is working on, to try to find a feasible way to do it, if it can be found I am going to be for withholding, even though it is different than withholding on wages. But I have had to come to the conclusion that we have not come up with it yet and a feasible way to do it is not in this bill without creating an undue burden on our people who have 500 million accounts scattered all around the country.

We therefore propose in our motion to recommit to strike this section.

Let me talk about the budget and fiscal effects a minute because that does concern some people. The majority of the committee went back to cut down the cost of the bill. There has been a lot of figure juggling in this whole thing. We have heard about this bill being in balance. We heard talk about the other bill being in balance.

First we had the items in the bill as reported by the committee. These are found in your committee report. Then the majority, as I stated, got scared that the deficit would be too big, so they went back and they added an amendment to the bill. This amendment will be presented. But, what will the bill cost now after this amendment is adopted?

The staff of the Joint Committee on Internal Revenue Taxation has furnished us with a report. When fully ef-

fective, according to the staff of the Joint Committee on Internal Revenue Taxation, this bill is still \$295 million a year out of balance. As far as fiscal 1963 is concerned, this bill is still \$1,090 million out of balance. Now, that is the estimate of the staff of the Joint Committee on Internal Revenue Taxation, and I will stand by their estimates much before I will stand by any Treasury estimates.

I will insert the prepared table at this point:

Revenue estimates for H.R. 10650

[In millions]

	Treasury	Staff
(a) Fully effective (table 1, p. 5, of report):		
Estimate in report.....	-\$505	-\$775
Committee amendment....	+625	+480
Final result.....	+120	-295
(b) Fiscal 1963 (table 3, p. 6, of report):		
Estimate in report.....	-1,425	-1,550
Committee amendment....	+625	+460
Final result.....	-800	-1,090
(c) Fiscal 1963 (with adjustment for incentive table 4, p. 7):		
Estimate in report.....	-660	-----
Committee amendment....	+350	-----
Final result.....	-310	-----

¹ Using full year effect.

Treasury hopes final result for fiscal 1963 will be no loss, for reasons indicated in footnote 1 to table 4 in report. [Not printed in RECORD.]

Now, also, contrary to what the chairman told you yesterday, these losses are not taken into account in the budget, and I would ask you to turn to the budget of the United States, the small one that they put out, and read on page 20 where the President says:

Any net reduction in fiscal 1963 revenues resulting from the adoption of the investment credit is expected to be offset by additional revenue resulting from the enactment of measures to remove defects and inequities in the tax structure.

And he goes on with these other items that were supposed to be in the bill. This budget does not take into consideration any fiscal effect of this bill presently before us and, as I just pointed out, you are still voting for a deficit, a shortage of receipts, of over \$1 billion in 1963 unless you get rid of this investment credit.

Now, what will be the effect if the motion to recommit is adopted? If you adopt the motion to recommit and strike out the investment credit and the section on withholding, where are you left fiscally? According to the staff of the Joint Committee on Internal Revenue Taxation, you will have a plus of \$500 million. If you use the figures of the Treasury, it will be \$560 million-plus.

I trust, Mr. Chairman, that the motion to recommit will be adopted and, if it is, I shall vote for the bill and for the passage of the bill, but if the motion to recommit is defeated, then the bill should be defeated and let those who insist on the \$1 billion tax bonanza take the responsibility.

(Mr. VANIK (at the request of Mr. MILLS) was given permission to extend his remarks at this point in the RECORD.)

Mr. VANIK. Mr. Chairman, during the course of the debate on this bill, I have endeavored to place into the RECORD my opposition to the investment tax credit and to the withholding provisions. The investment tax credit creates a bigger loophole than those which the bill attempts to close. I fear that if this tax credit is adopted, it would simply serve to stimulate higher investment credit in periods of high profits in order to conserve tax liability. In periods of recession and reduced profits there would be less or no taxable income toward which the credit would apply. Thus the credit will serve to increase the severity of economic impact. The annual loss to the Treasury will increase until it reaches over \$26 billion in the next 10 years.

I represent a community where perhaps less than 10 percent of the residents own any stock and where the average bank deposit is under \$1,000. In my judgment the \$8 withheld from these savings accounts would constitute improper withholding and result in the unjust enrichment by the Federal Government. The overwhelming number of people in my district—whether they report interest income or not—are overpaying their Federal taxes. They file short forms. They overlook hundreds of millions of dollars in allowable deductions which would reduce their taxes. They will be reluctant and overly cautious in signing exemption applications. Their withheld income will be confiscated for all practical purposes. They will develop a bitterness against the entire income tax system and join in causes to destroy it.

They are bitter about big loopholes in our tax laws. Why do we omit discussion of the oil depletion allowances, the capital gains loophole, the stock option abuse? Has it become a violation of the rules of the House to discuss the propriety of reducing the fat oil and gas depletion allowances?

If the motion to recommit removes the sections on investment credit and withholding my objections to this bill have been substantially met and I must support such a motion. I cannot permit partisan considerations to keep me from doing what I believe should be done.

(Mr. STEED (at the request of Mr. MILLS) was given permission to extend his remarks at this point in the RECORD.)

Mr. STEED. Mr. Chairman, those of us who have a particular interest in the smaller businesses of this country have over a long period of time developed an approach, and almost an instinctive way of looking at proposed legislation. Legislation which is described by its sponsors as being "in the national interest" is frequently in the interest of only a small portion of the Nation. And, all too commonly, it is the big business element of the economy which will benefit from the legislation, either to the exclusion of or directly contrary to the interests of the small business community.

Small business encompasses so many variables that the impact of a particular piece of legislation is bound to vary, depending upon the competition in the industry, the point in the chain of pro-

duction or distribution at which the business is placed, and so forth. So it is not always easy to gage the effect of a bill upon small business. But, if we are to keep alive the small business element of our economy, it is absolutely essential that an attempt be made to analyze every piece of legislation from this point of view. Unlike big business interests, the small business community has neither the resources nor the experience to make itself heard. So, if such an examination is not made here—in the Congress itself—it is likely that it will not be made at all.

The Revenue Act of 1962—and particularly the investment credit—is no exception to this general rule. There are many of us who are in complete accord with the motivating policy behind the legislation. It is crystal clear that, in order to maintain the economic health of this country, it is necessary to raise our level of investment in productive equipment. The rate of growth necessary to continued and expanded national prosperity; the attainment of full employment; the restoration of a balance in our international payments—all these can be helped immeasurably by an increase in investment in more modern and more efficient equipment. The granting of a tax credit, based upon the amount of such investment, is quite obviously a powerful incentive in this direction.

But, granting that big and powerful enterprises will benefit from such a tax credit, the troublesome question which must linger in the minds of many Congressmen is this: What is in it for small business? Is this simply another instance of legislation designed to aid big business, with only an incidental boost to the small firms which constitute the vast majority of all American businesses? Certainly this is a legitimate question, and one with which we should concern ourselves today.

The first area of scrutiny is, logically, the type of purchases which would be eligible for the credit under the proposed legislation. It is important to note that not only machinery or heavy equipment is eligible, but also cash registers, counters, refrigeration equipment, and so forth. Thus, manufacturers are not the sole beneficiaries of this bill. Small wholesalers, retailers—small businesses in every trade and every role—will be able to benefit.

Further, used assets—which are more likely to be sought by the small firm than by its larger competitors—are eligible to the extent of \$50,000 a year. There are comparatively few small businesses whose purchases of used equipment, even under the impetus of a tax incentive, would exceed that figure. From the point of view of the small firm, it is particularly interesting to note a side benefit which can be expected to develop. The credit, by accelerating modernization, should certainly increase the supply and thus reduce the prices of used machinery and equipment replaced by the purchase of new assets.

Inventory is not included among the types of purchases which would be eligible for the credit. The small businessman does not suffer particularly from

the exclusion; rather, it is the giant retailer, who could use excess funds to increase his inventory substantially, who would get a windfall if the legislation were to include such a provision. A substitute proposal includes a reduction in closing inventory. It is apparent that a one-shot reduction of this nature would be of dubious value as a lasting and sustained incentive; that the stimulus to increases in inventory would be incongruous in a bill designed to encourage modernization of productive facilities; and that it is readily subject to abuse.

Further, from the point of view of the small businessman, such a provision might well be a curse in the guise of a blessing. Since reduced closing inventory becomes reduced opening inventories of the following year, the tax bite is postponed only so long as sales and purchases remain at a high level. When a firm is confronted with declining sales and the need to curtail inventory, however, the chickens come home to roost; the tax payable is increased at the worst possible time.

As to the choice between a credit and a form of increased depreciation deduction, there can be no doubt as to the superiority of the credit. The credit not only acts as a substantially more effective incentive to increased investment; it also has some distinct advantages from the point of view of the small firm. The credit is a direct reduction of tax liability. It does not affect a firm's pretax earnings figure, as would increased depreciation. The small business, which even in the best of times has difficulty showing a sufficiently favorable profits statement to obtain adequate financing, is taking a real risk by increasing its depreciation and thereby impairing its earnings. The credit, on the other hand, presents no such problems. Quite the contrary, it increases cash flow and increases the profitability of new investment, without affecting pretax earnings. Further, it leaves the tax basis untouched. An increased deduction, of course, reduces the basis against which further depreciation may be taken.

This comparison is on the assumption that the alternative to the credit is a form of actual increased deduction. The substitute proposal, however, does not even do that; it simply shortens by approximately one-sixth the period of time during which a taxpayer may take the very same deductions as are available under existing law.

The most important distinction between the two approaches is, of course, the impact which each has upon the lower bracket taxpayer. The deduction for depreciation takes the form of a reduction of income, the value of which in terms of tax saving is much greater for the high-bracket taxpayer. The credit, on the other hand, simply takes the form of a deduction from tax liability.

Thus, a 7-percent credit against tax liability is equivalent to a first-year deduction—over and above allowable depreciation—of \$14 per \$100 of eligible investment for corporations subject to the 52-percent corporate income-tax rate. But, for a corporation with taxable income of less than \$25,000, and

therefore subject only to the 30-percent normal tax rate, the equivalent deduction is more than \$23. For an unincorporated businessman subject only to the 20-percent starting rate for individuals, the equivalent deduction is \$35. For the small businessman, then, the credit is clearly the more desirable approach.

Finally, I should like to point out that the limitation on the amount of tax liability which may be eliminated by the credit is almost irrelevant to the small business community. The recent reduction in the limitation, to \$25,000 plus 25 percent of the tax in excess of that amount, actually had the effect of increasing the proportion of the total benefits provided by the legislation which flows to small business. The new lower limit will not affect any business whose expenditures on eligible equipment do not exceed \$357,000 per year. Obviously, no more than a handful of truly small businesses would be adversely affected by such a provision. That this is so is illustrated by the fact that the maximum business loan which the Small Business Administration can make to a small business—including the cost of construction, as well as the purchase of equipment—has been set by Congress at \$350,000.

In short, I have been measurably reassured by my scrutiny of the bill. It is not a windfall to big business. It does not simply scratch the back of the fat cats. It is not designed primarily as a boon to large enterprises which would be making such expenditures even in the absence of the legislation. It is a significant contribution toward the strengthening of our economy. And it does adequately provide for the interests of small business.

I am for it.

(Mr. HEMPHILL (at the request of Mr. MILLS) was given permission to extend his remarks at this point in the RECORD.)

Mr. HEMPHILL. Mr. Chairman, on yesterday, I voted against the previous question and against the rule allowing debate on this bill. I wanted the Ways and Means Committee to take this bill back and rewrite it. I know they were crying this was the best they could do, but I was of the opinion they could do better. I also voted against the rule because I wanted to have open and free debate. I did not believe it when they said it would take a week to study out this legislation and debate it out and that the House could not work its will. I would not have cared if it had taken a month.

I do not like the withholding feature in particular. I am happy they eliminated any withholding of people not liable for tax and under 18 as I was much concerned that the savings of old and young people would be greatly affected.

We of the textile area are most happy that the President of the United States has seen fit to try to help the textile people. The period of starvation has been a long one and the previous administration exhibited the worse sort of hypocrisy in dealing with the textile industry. I think they wanted the textile money and the textile support, but did not want to be of any real help, and they were not.

This new incentive plan should be a great help in retooling and expanding the textile industry so necessary to our part of the country. New industry means new jobs, steady employment, consumer market and 1,000 other things beneficial to our people. Along with a few others here of the affected textile areas, I have often voiced my concern over the plight of the textile industry in the future.

President Kennedy is the first President I have served under who ever offered any real sympathy or took any partial action. For this reason, I endorse that particular feature of the legislation.

I am well aware of the fact that the tax treatment with reference to foreign properties and investments will be changed. Certainly the American investor and the American industrialist needs to have something done to protect the export of American capital, American manufacturing and American jobs. Why should the American manufacturer or investor be penalized because of domestic investments? It does not make sense.

I am happy that the original plan of the tax treatment of the saving and loan institutions was changed. The initial approach was too harsh, and, along with others, I contacted members of the Ways and Means Committee hoping to lessen the harshness of the treatment. I am happy that the Ways and Means Committee did lessen the harshness, and I salute the distinguished Congressman from New York, Hon. EUGENE KEOGH, for his unflinching efforts to help the thrift institutions.

Again, I say I do not like the withholding, but I do not want to work an injustice on all of us who, salaried, have to pay withholding.

Mr. MILLS. Mr. Chairman, I yield myself 10 minutes.

Mr. ALBERT. Mr. Chairman, will the distinguished gentleman yield?

Mr. MILLS. Gladly.

Mr. ALBERT. Mr. Chairman, as the debate on this important matter draws to a close, I think it would be in order for me to say that I believe I express the feeling of all the Members of the House on both sides of the aisle when I say that the management of this bill by the distinguished gentleman from Arkansas, [Mr. MILLS] has given us legislative leadership of the highest order. Those who have listened to the debate on this bill, as I have, will also agree with me, I am sure, when I say that this debate has been in the finest traditions of the House of Representatives. The Committee on Ways and Means has done a tremendous job with a difficult subject over a long period of time and has brought this bill to the House for our consideration. I had hoped that the distinguished minority leader of the House, the gentleman from Indiana [Mr. HALLECK], for whom I have great personal affection and the highest regard, would have found it possible to support this bill.

I am sorry that this bill has taken, as it did on the motion on the previous question on the resolution that made the rule in order, a partisan direction. I had hoped that this bill could be sup-

ported as we supported the Manpower Retraining Act a few days ago in a bipartisan spirit. But, Mr. Chairman, I am prepared to say that if we must pass this bill by Democratic votes, we are prepared to take the responsibility. We believe this bill is good for America and that whatever is good for America is good for either political party.

Mr. Chairman, those who have said that we should strike out the investment credit provision, which stands out in bold letters in the title of this bill, remind me, if the distinguished gentleman from Arkansas will yield further for that purpose, of the old Arkansas story of a man who was cleaning a White River catfish and when it started squirming he said, "Hold still, fish, all I am going to do is to try to gut you."

Mr. Chairman, it seems to me that the presentation which the gentleman from Arkansas has made, and others on his committee, has made it clear that this is the heart and the soul of the measure.

I am not one, Mr. Chairman, who believes that the treatment we give to one taxpayer should not be applicable also to another. I see no reason why we should treat the man who works for wages differently from the person who receives his incomes from dividends or interest. Above all, I do not for my part desire to vote to permit a large group of taxpayers to continue to evade the payment of their taxes.

Mr. Chairman, if the gentleman will yield further, I would like to take this opportunity, since it has been referred to, and because I think it states the position of those of us who are supporting this bill, to read the statement of the President of the United States on this bill at his weekly press conference this morning, and I read:

I want to take this opportunity to stress again the importance of the tax bill now before the House of Representatives. An attempt is being made in that House to defeat this bill by sending it back to committee, and if it is killed, we will have lost a most valuable opportunity to find jobs for the college and high school graduates who will be seeking those jobs in June of this year. We will lose our best hope of modernizing our machinery and our equipment, and giving our industry an inducement to step up their investment so that they can compete on more equal terms with foreign investors and producers.

We will be abandoning an effort to close those foreign tax havens that drain our jobs and dollars away from our shores, and we will be permitting \$630 million a year in taxes due from stockholders and bondholders to go uncollected, even though these taxes are on the books. Even though one-third of these people are paying their taxes in good faith, yet because of the difficulty of collecting them, nearly \$630 million due to the Treasury does not come in each year, which means that those wage earners, the small business men and others who have their taxes withheld from their salaries and their paychecks must pay more.

We need this bill, finally, to help close off our loss of gold in our balance of payments. To make that less, we must modernize our equipment and our businesses so that they can compete, and we must close the loopholes which permit and encourage industry to invest overseas. I hope that every Member of the House of Representatives who believes in spreading the tax burdens fairly, who wants to improve our balance-of-pay-

ments position, who wants this country to grow with new equipment and new jobs, will support this bill as the best means of achieving these goals today. And I find great difficulty in understanding the position of any political party which makes it a matter of party objective to defeat this bill at this most important time.

Mr. HALLECK. Mr. Chairman, will the gentleman yield to me for a brief observation?

Mr. MILLS. I am glad to yield to the gentleman from Indiana.

Mr. HALLECK. Mr. Chairman, I listened with attention to what I understand are words from the President of the United States. As I understood it, he said that an attempt will be made to send the bill back to the committee, to kill it. I am sure the gentleman from Arkansas will understand that a motion to recommit with instructions directs the committee to report back forthwith with whatever instructions the motion to recommit contains. Then we vote on that as an amendment to the bill, back in the House, and then we go on to pass the bill or defeat it, whatever may be the case.

Mr. MILLS. The gentleman from Indiana has properly stated the situation, as I understand it; and that is why I wanted to take just a few minutes to point out why I thought my friend from Indiana [Mr. HALLECK] and those who intended to vote for a motion to recommit were making a mistake.

Mr. Chairman, I have nothing but the greatest respect, admiration, and affection for every Member of this House regardless of his political party. I know that when a majority of the membership of this House becomes informed and advised with respect to a matter, almost without exception that majority will do the right thing.

Mr. Chairman, there is no argument on the part of our Democratic colleagues or Republican colleagues on the Committee on Ways and Means about the requirements of the future for providing improved ways for business to recoup out of profits before taxes the investments that they make in the operation of the business and the creation of jobs. There is an argument about whether or not we should provide any of that recoupment through an investment credit. There is an argument about whether we should adopt this provision, and it is referred to as a gimmick. I said on yesterday, Mr. Chairman, that I originally had as much question about this proposition as anybody in the Congress ever had. I went into it, as did my Democratic colleagues on the Committee on Ways and Means. Of their own free volition, after having studied the matter fully, they concluded that it was in the national interest. It is in the national interest. And Mr. Chairman, during consideration of this matter by the committee as originally proposed with the help of the Republican members of the committee, we approved the investment credit provision by making it nondiscriminatory, by providing a flat rate, and by making it apply to those who are small as well as to those who operate the larger businesses. We made it applicable to the operations of the dairy farmer in

Wisconsin as well as to the cotton farmer in Arkansas.

Mr. Chairman, I feel as confidently about this point as I have ever felt about anything that this is a step in the right direction to help business to gain momentum in the creation of jobs.

Now let us see what my friend, the gentleman from Wisconsin, says and let us see what his position is, and I have great respect for him. The gentleman from Wisconsin bemoans the fact that the committee has seen fit to go into the operations of foreign corporations owned by Americans and to tax certain profits of their businesses by saying they cannot be deferred from the American tax. I have some sympathy with that point of view. But then what does he say? He says, "I am perfectly willing for these American-owned profits abroad to be deferred from the American tax, but I ask the membership of this House to deny an American business operating here at home, which is trying to create more profits and more employment—deny that business even a 7-percent investment credit."

Now I am interested in the operation of American-owned businesses abroad as well as he is, in seeing that they can operate, but I am also interested in the operation of businesses here in the United States that I know will be helped as the result of this section of the bill dealing with the investment credit.

He suggests that we take out of the bill in his motion to recommit the provision for withholding of tax on interest and dividends, and they have offered every conceivable excuse in the world for not wanting it. They say it will cause overwithholding. They say it imposes a burden upon people who live off interest and dividends that ought not to be imposed upon them. They say it will cause a lot of paperwork. But what are they suggesting as an alternative? They are asking you to strike this out and let the Internal Revenue Service collect this money by making these cross-checks with their automatic data processing machines. How much is involved in this cross-checking? Can the Internal Revenue Service with their machines check a return without having the information recorded from a report from somebody on interest and dividends? Ask your bankers, ask your building and loan people and ask your mutual savings banks which they would prefer. Ask them whether they prefer to have to write down the name and address of everyone to whom they pay interest and the amount or would they rather do it through a simple and efficient system of withholding. The fact of the matter is that the only way in the world that their suggestion would work would be to have every dollar of interest paid by everyone of these institutions reported to the Internal Revenue Service and the Internal Revenue Service as an adjunct of the Treasury Department has that authority today. Do you want to defeat this and force the Internal Revenue Service into that position in order to collect this \$800 million-plus that is now escaping from taxation? I do not think a reasonable person would say that that

procedure which will be forced upon these institutions would be preferable to the procedure we provide for in the bill. And then we hear some say, "You are not going to help these people. They will have to file this statement every year that they owe no tax." Of course, that is true, but they overlook the fact that the bill does provide the authority once this is done and an experience record is established to permit the Secretary of the Treasury to dispense with that requirement for filing of these statements each year.

But there is one thing, my friends I think are overlooking. What effect does this proposal to strike out the withholding provision have on the payment of taxes by the American farmer? The provision on cooperatives in this bill states that the cooperative when it allocates to the American farmer who is a member of that cooperative a part of the profits from the business that he is giving to the cooperative, there shall be a withholding of tax. We have said in the withholding provision that we do not think it is fair for this cooperative to hold his money requiring him to pay the tax out of the profits from other income on this income that is being withheld from him by the cooperative. So we say the cooperative must give up 20 percent of the amount allocated to its patrons to cover the first bracket of the tax of this farmer.

Mr. BYRNES of Wisconsin. Mr. Chairman, will the gentleman yield?

Mr. MILLS. I yield.

Mr. BYRNES of Wisconsin. Can the gentleman tell us how this cooperative will handle the exemption certificate? How are they to tell what is going to be withheld on other funds?

Mr. MILLS. The cooperative will handle the exemption certificates all right. The gentleman realizes the same rules apply here that apply to other payors. But what I am concerned about is that the gentleman has not provided in his motion to recommit a motion to strike out this arrangement on cooperatives that will impose upon his farmers and my farmers the requirement to pay a tax on money that the cooperative is withholding out of his pocket and not giving to him.

This provision in the bill says that the cooperative must pay 20 percent to the Government to represent the first bracket of the tax of that farmer. I hope, therefore, that those of you who are concerned about this aspect of the matter will think twice before you vote for the motion to recommit.

Mr. Chairman, I hope that the membership of the House, not on a partisan basis, will vote down this motion to recommit. I hope then that the membership again not on a partisan basis will send this bill on to the Senate where hearings have already been scheduled to begin, I think, on Tuesday of next week, where adjustments, if necessary, can be made in it filling the needs and the requirements of the hour as seen by those in the other body.

Mr. Chairman, I urge the passage of this bill. I urge the rejection of this motion to recommit.

The CHAIRMAN. The gentleman from Arkansas has 10 minutes remaining.

Mr. MILLS. Mr. Chairman, I yield to the gentleman from Louisiana to submit a consent request. He has a number of Members who wish to extend their remarks at this point, whose names he will read.

Mr. BOGGS. Mr. Chairman, I ask unanimous consent that the gentleman from Idaho [Mr. HARDING] may extend his remarks at this point in the RECORD.

The CHAIRMAN. Is there objection to the request of the gentleman from Louisiana?

There was no objection.

[Mr. HARDING'S remarks will appear hereafter in the Appendix.]

Mr. WHARTON. Mr. Chairman, it is clear that we have here just another attempt at revenue revision, rather than legislation designed to raise necessary funds for the Federal Government to operate.

This bill proposes to reduce Federal income via a 7-percent subsidy to industry on new equipment. On the other hand, it aims to penalize our businessmen who have successfully penetrated foreign markets. Possibly the administration feels that this would be an even break, but I have serious doubts on that score.

Next we come to the controversial withholding provision aimed at that substantial segment of the American people who have worked and saved money, investing it in a savings institution or in dividend paying stocks. Whether 20 percent of their income is withheld or they file a sort of paupers' oath stating their low incomes are not subject to taxation, they are involved in bureaucracy, delay, and redtape where they have never been before. Mind you, these are the people who habitually pay their tax, their funds are right there on deposit as security to the Government in case they do not, and they know it. Now, we hear a great deal about tax loopholes. How about gambling establishments, racetracks, and sporting events where it is a well-known fact that, frequently, no tax whatsoever is collected on taxable income?

During my 12 years in the House, I have never received such a volume of mail unanimously opposed to a single bill. It comes almost entirely from little people who rely upon this income after a life of toil and savings. Have we reached a point where the old-fashioned virtues are to be penalized by bureaucracy, delay, and redtape? Avid supporters of the Kennedy administration say that they are reluctant to go along with this measure, and I hope that they will heed their consciences in preference to political expediency.

As someone has very aptly put it, the whole ramshackle structure of Federal taxes is a tangled growth of imposts tacked onto the last clear thought on taxation back in Woodrow Wilson's time.

No adjustment for tax grievance in any one sector of American life, no denial of established tax privilege to any one

sector of American life can correct the Federal tax system without creating new injustices.

This withholding proposal clearly demonstrates that taxes require thinking through all over again, and the bill should be returned to committee.

Mr. SANTANGELO. Mr. Chairman, I oppose the motion to recommit and support this tax bill.

Fiscal responsibility requires that we raise and provide the funds to carry out the progressive programs of the Kennedy administration. To do otherwise would be irresponsible.

The motion to recommit seeks to eliminate the tax incentive features for our industry. It would prevent the expansion of their facilities to provide additional employment and which would enable them to compete with foreign industries and earn profits upon which they could pay taxes. The incentive program is a far-reaching and farsighted program and will promote the rate of growth of industry in our country so that it could compare with the rate of growth in those countries in Europe which were devastated by the war and which had to rebuild from the ground up.

The second feature of the motion to recommit is to prevent the withholding of taxes on interest and dividends. The wage earners of our country pay their taxes when their employers withhold the tax on their wages. The professional man, the businessman and the nonsalaried workers pay estimated taxes on the estimated earnings or profits from their occupation or profession. For the past several years our Government and especially the Internal Revenue has engaged in a publicity campaign urging the American people to pay taxes on the interest they receive on their savings accounts and on dividends which they receive on their investments.

To a certain extent some of our citizens have heeded the call of their Government and have paid their taxes on their interest and dividends. But, unfortunately, a large percentage of American taxpayers have failed to report their interest and dividend payments. It has been reliably estimated that over \$4 billion of interest and dividends have not been reported. The estimated tax on this unreported and undisclosed income would be approximately \$824 million. Another lower estimate is \$625 million. In any event, it is a sizable sum. The nonpayment of these taxes by the shirking taxpayers puts a burden upon the honest citizen who has his taxes taken from his wages or who pays his estimated tax and who reports truthfully the interest and dividends he receives.

A vote against this tax bill is a vote to permit those taxpayers who seek to cheat the Government to put upon the honest taxpayers a burden which they should not sustain.

Safeguards are provided for in this bill. Children under the age of 18 are exempt from paying taxes on their interest or dividends because they are not taxpayers or earn insufficient funds.

Our senior citizens above the age of

65 are also exempt from the provisions of withholding taxes on interest or dividends.

Those taxpayers between the ages of 18 and 65 who believe that the interest and dividends are not sufficient for them to pay taxes may be exempt by filing a certificate so stating and they will thereby be exempt from the withholding provisions.

During this year we have approved measures which would give aid to the unemployed, and aid to dependent children. We have increased payments to the aged of our community and to the blind and disabled. The cost of such a program was \$140 million. This requires the raising of money in order to provide the much needed facilities and help which we, as a responsible and understanding and humanitarian government, want to provide for our less fortunate people. To vote against this tax bill while at the same time voting in favor of the authorization for such programs is being hypocritical and dishonest.

When we approve a far-reaching program, as responsible legislators, we must raise the funds to provide the money to implement and carry out the beneficial programs that we adopt. This measure is a far-reaching measure. It will carry out the Kennedy program and will move our government forward. It will tax those American citizens who are living in Europe and who are exempt on the first \$35,000 of their income. This bill reaches out and equalizes the competitive conditions between different types of banks and insurance companies. It will permit us to provide for the defense of our country and to continue the programs in outer space and to develop heroes like John Glenn.

Without the funds to carry on this research, we cannot compete with a totalitarian monolithic government like Russia. To oppose this measure would be to grant to the communistic countries an advantage over our democracy. On balance this is a very important measure and as a responsible American citizen and as a person who believes we must implement the social programs espoused by the Democratic Party, I must vote for this tax measure.

I trust that the motion to recommit will be defeated and that this measure will pass.

Mr. O'HARA of Illinois. Mr. Chairman, I am supporting H.R. 10650 because I believe firmly that a tax bill must be balanced and that the best guide for the action of the House is the recommendation of a majority of the members of the Ways and Means Committee, who wrestle for days and weeks with the complex and technical problems of taxation. The Honorable THOMAS J. O'BRIEN is the Chicago member of that distinguished committee. No man is held in higher esteem by the Members of this body and none has a richer background in experience.

Taxes never are popular with those upon whom they are imposed, and yet no American would wish our Govern-

ment, our way of life, our economy, and our security to fall apart because of lack of revenues. I suppose no tax bill is entirely pleasing to everyone. If tax bills were not brought to the House in blanket form, and members who had not had the benefit of the lengthy hearings and studies of the Ways and Means Committee were permitted to vote on each item according to their individual whims or interests, we could expect legislative chaos and surely would end up with a barren Treasury. No matter what administration is in power, Democratic or Republican, I feel that a sense of fiscal responsibility compels my support of a blanket tax bill reported by the Ways and Means Committee, even though there may be items on which I would be in disagreement, as doubtless is the case with members of the Ways and Means Committee. After all, in the final analysis good legislation is the child of compromise.

I commend the great Ways and Means Committee on the manner in which in the present bill it has worked out differences in the spirit of compromise. I was troubled by the many letters I had received from aged persons, subsisting on small returns in interest and dividends, and who could ill afford to have withholdings even for a brief time of the money they needed for livelihood. That the Ways and Means Committee worked out in a sympathetic commonsense manner by providing that there would be no withholding when one notified the Government in writing that his total taxable income would not subject him to an income tax. Fair and simple, the bill assures the Government getting the tax from those who should pay, gives complete immunity of withholding to those who have no tax liability.

In the last Congress I have supported the bill introduced by the very able gentleman from Louisiana [Mr. Boggs], as regards taxation of American industries with foreign operations. The approach in H.R. 10650 is different and this is in an area where there may be honest differences of opinion, largely stemming from the fact that there is scant historic background and shifting conditions in a changing world give confusion to the making of charts. The gentleman from Louisiana is supporting H.R. 10650—indeed his speech this afternoon ranks with the great orations in the history of this Chamber—and this is proof conclusive that he accepts the provision in the present bill, subject to revision later if circumstances and developments would seem to demand.

Mr. Chairman, while supporting H.R. 10650 as necessary tax legislation if our Government is to have the funds for survival, and every legitimate source of tax income is tapped according to its ability and its responsibility, I think it only fair that I should include in my remarks some excerpts from a letter I received today from Lajos Schmidt, distinguished Chicago lawyer and member of one of the Nation's largest law firms specializing in international law. Mr. Schmidt writes me from London:

In writing this letter from London I want you to know the feeling of the American business community abroad, as well as the feeling of leading foreign businessmen, on the effect of H.R. 10650. * * *

Leading foreign businessmen have in fact stated that this legislation would seriously hamper the competitiveness of American companies abroad. As you know, it is increasingly difficult to export finished merchandise from the United States because of the extremely high cost of American labor. As a defense, the ingenuity of American businessmen discovered the possibility of exporting parts and components from the United States and transforming same into finished goods abroad. Through this device hundreds of thousands of new jobs were created in the United States. In fact, it is my opinion that our export volume has increased from year to year partly due to the extremely substantial production of parts and spare parts exported from the United States to controlled foreign subsidiaries. In order to stay competitive in the foreign markets—notwithstanding the handicap of expensive labor—American companies provided sales and service support for their domestic and foreign manufacturing companies through so-called base companies which derived a part of the profit and provided the foreign manufacturing and assembly plants with fixed and working capital.

The new legislation will eliminate the most useful activities of the so-called base companies. The result will be either that these foreign companies will not be able to expand, and thus utilize an increased number of American parts and components and production parts and the multimillion dollars worth of capital assets, or that the U.S. parent companies must contribute investment funds to these foreign enterprises in order to keep them competitive. In both instances the results are disastrous. In the first instance, American job opportunities will be lost and our balance of payments will deteriorate through a diminishing amount of export from the United States. In the second instance, capital, which otherwise would have been used for investment purposes in the United States, would flow abroad which would finally result in a decreased investment and productivity in the United States itself.

Your friends like Congressman Boggs and others who explored all the ins and outs of this question reached the conclusion that H.R. 5 would have helped American foreign business and the American economy in general. As you stated, in your opinion Congressman Boggs is one of the ablest Members of the House.

Mr. ALGER. Mr. Chairman, too little attention in this debate, it seems to me, has been given to the comparative consideration of this tax bill and the Trade Expansion Act of 1962, both measures coming before the Ways and Means Committee. Interestingly enough, both give evidence to the attempt being made by both the administration and Democratic congressional leaders to lessen the competitive position economically of the United States in the world today. Three general and related statements can be made about the provisions of these bills, even before any attempt is made to wonder why this is being done. First, both bills lessen U.S. industry's ability to compete in the world market. Second, both bills increase Government's control over industry and in so doing threaten to destroy private enterprise, replacing our private ingenuity and incentive with

Government-controlled industry. The answer to socialism, communism's challenge of government-controlled industry is not to shackle our own with similar controls. On the contrary, we should free up our industry in both tax and trade to place our Nation in a better position economically to compete for the world's market, as freemen and private enterprise.

Freedom and private enterprise can run circles around men who work for government in government-controlled industries.

Let us look at both the tax and trade bills. The minority report, the Republican separate views state the case well, on the tax effect of U.S. foreign controlled corporations—pages 21–27 of the report. These points are made:

First. Congress cannot constitutionally tax shareholders on the undisturbed income of foreign corporations, except in case of evasion. Until the court decides this after costly litigation we will not know if this tax is even constitutional.

Second. This tax bill reverses a long standing U.S. policy of encouraging expansion of U.S. industry abroad. Trade not aid was part of this theme.

Third. Tax deferral abroad was considered so important last year by the Democrats that H.R. 5 was sponsored with this statement in the report of their position:

The postponement of American tax as long as the funds are used in foreign operations is necessary to place the U.S. corporations operating abroad on a competitive basis with other corporations, either United States or foreign owned, which operate in the same foreign countries.

Today's tax bill completely reverses this policy of last year and many years in the past, placing our U.S. corporations at a disadvantage by now increasing their tax burden.

Fourth. Foreign investment of U.S. industry that accumulates abroad in the long run helps, not hurts, the balance-of-payments problem because a dollar invested abroad increases exports from the United States and produces dividends to the American investor which ultimately exceed the dollar invested. This bill now contradicts this undisputed logic.

Fifth. Any attempt to keep American business at home through the tax laws is isolationism at its worst. The tax laws would then become the equivalent of a discriminatory tariff or duty, applicable only to the American-owned business operating overseas but not to its foreign-owned competitor.

Sixth. Until there is free trade with others, nations lowering tariffs to meet ours, Congress should not penalize the American businessman further for going abroad in order to seek and make a place in that market.

Seventh. American corporations must compete with foreign owned. If the American firm cannot invest equally abroad with his competitors, foreign capital will take its place. Then income flowing back to the United States will be less.

Eighth. The other 14 major industrial nations do not tax undistributed earn-

ings as we are here seeking to do. On the contrary many adopt tax incentives to encourage investment abroad.

Ninth. Liberalized depreciation, not investment credit, as here proposed is the area too where foreign nations can outcompete the United States. In the first 5 years, while U.S. industry can depreciate less than 50 percent of the cost of equipment Japan can write off 100 percent, Germany 67 percent, and others can do likewise.

Tenth. The use of so-called tax havens by an American-owned foreign company actually produces more tax revenue for the United States when funds are repatriated.

Eleventh. The tax bill is likely to cause foreign nations to increase their tax of U.S. industry there to soak up the differential in tax which would otherwise go to the United States. This too will serve to drive American business out of the European market.

Twelfth. The tax on U.S.-controlled foreign corporations violates our tax treaties with other nations. For one, the U.S. membership of the Organization for Economic Cooperation and Development—OECD—permits the United States taxing American shareholders only on those profits which are distributed by the company. This bill violates our agreements with Sweden, the United Kingdom, Germany, France, Netherlands, Denmark, Norway, Switzerland, Austria, Italy, Belgium, Greece, Ireland, and Canada.

Boil these statements down—they say one thing. American firms are in for tougher times in trying to compete in the world market.

Now let us look at the Trade Expansion Act of 1962. The President is given carte blanche authority to cut tariffs 50 percent on broad categories of products and remove all tariffs that are lower than 5 percent. What is and what will be American industry's position in world market? Will it be easier to compete or not?

First of all, U.S. tariffs are now among the lowest in the world. Others in reciprocal trade agreements do not match ours.

On the contrary they impose, in violation of GATT agreements, quotas, licenses, embargoes, cartels, registrations, levies, and subsidies and many other restrictive controls, more restrictive than are tariffs as a control of the free flow of trade. American industries are already hurt not because of ability to compete but because other nations unfairly keep up trade barriers. So what will lowering our tariffs accomplish? Further harm to U.S. industry, less ability to compete. The Trade Act of 1962 asks the Congress to abandon, first, the no-injury policy; second, item-by-item consideration of products in trade; third, the peril point and escape clause protection; fourth, Tariff Commission findings. In place of this the shift of power goes to the President or to whomever he delegates to single out industries and products for devastating foreign competition by lowering our tariffs while others keep up their tariffs and other controls. Then the President, or whom-

ever he delegates, can single out or deny any industry harmed for Federal aid in loans, guarantees, and advisory help as well as monetary assistance to that industry's workers who are displaced by foreign imports; fifth, any court review; sixth, congressional jurisdiction.

Now put the two bills together. What do we have? We have a tremendous increase of governmental control over industry and the transfer of tremendous power to the President by Congress over U.S. industry, dictatorial in scope, beyond recall or repair in damage. Of course, political friends or foes can be properly rewarded or punished. Beyond dictatorial power we see, second, U.S. industry cannot compete with other nations if our creative genius and private initiative is destroyed by bureaucratic governmental control through tax and tariff. Destroyed it will be through regulation by tax and tariff as these bills spell out. Well might we pause to ask ourselves, what is our national purpose? Who is behind this scheme? Why does the President and the Democratic leaders of Congress insist on these two pieces of bad legislation? Our only hope lies in the commonsense and intelligence of our people to see the danger and deny this power and governmental control over our private enterprise and personal freedoms.

Mr. PELLY. Mr. Chairman, several days ago, on March 19, I introduced legislation, H.R. 10809, to amend the Export Control Act of 1949, to extend such act for 2 additional years and to require a prohibition thereunder of all exports of agricultural commodities to Communist countries.

H.R. 10809 would not only extend the Export Control Act of 1949 for 2 additional years, but it would bring Public Law 480 as administered under the Export Control Act into line with the foreign aid law, Public Law 87-197, thus eliminating the inconsistency in our foreign policy with respect to these exports.

I explored this matter in some detail in my remarks incident to the introduction of the bill. As a result, my office has been the recipient of a large volume of mail from hundreds of people almost 100 percent in support of the legislation.

One letter which I received a day or two ago is from a young lady, an anti-Communist student of Taiwan, presently residing here in Washington, D.C. Included with her letter was an English translation of an editorial which appeared in the Central Daily News, Taipei, Free China, under date of March 20, 1962. I am informed that the Central Daily News is regarded as the most influential and esteemed newspaper in free China. Inasmuch as these editorial comments are on the subject of food to Red China, I believe it is particularly appropriate to include the text of the editorial comments in the CONGRESSIONAL RECORD, as an additional argument for the passage of H.R. 10809:

FAMINE RELIEF VERSUS SUPPLY TO THE ENEMY

Following Pearl S. Buck's letter to the editor of the Washington Post, advocating sale of U.S. surplus food to Communist China, it

is reported that two American trade corporations are applying export licenses from the U.S. Government for shipment of food grains to the Reds. As humanitarian reasons are widely used in this matter, we wish to call attention to the difference between famine relief and supply to the enemy from a humanitarian point of view. Without a clear understanding of this important point, any famine relief can only strengthen the vicious force on the mainland and good intention may well produce bitter results. That is a very dangerous game.

We, the free Chinese, are, as always, very much concerned about our brethren on the mainland who are living in misery under the cruel rule of international communism. We have repeatedly endeavored to work out some sort of arrangement to relieve the famine on the mainland. We had made appeals to international charity organizations with a view to contacting the Chinese Communists indirectly, in the hope that some ports at the mainland coast might eventually be opened, so that food could be brought into the mainland and be distributed to the starving people. However, the cold-blooded Communists, without the slightest regard to the welfare of the people, relentlessly rejected our offer.

The Chinese Communists have not been inactive on this matter. They began to buy food from the free world since the beginning of last year. They bought 28 million bushels of wheat and 12 million bushels of barley in their first transaction with Canada, and 2,200,000 bushels of wheat in the second, and 186,700,000 bushels of wheat and 46,700,000 bushels of barley in the third. Of those transactions, as we had closely watched, not even a single word had been mentioned in their broadcasts, newspapers, magazines, and official publications by the Communists. On February 28 this year, Prime Minister Deifenbaker of Canada announced that shipments of grains sold to Red China started from last June. However, among thousands of thousands of letters we received from our relatives on the mainland, none of them indicated any knowledge of such grains, and among thousands of thousands of people who escaped recently from the mainland, none of them ever ate such wheat or barley.

Then where have those grains been? They were disposed of by the Communist leaders. Some of them were used to feed the soldiers who are guarding the regime, some went to other Communist countries, such as Albania, to uphold Red China's international prestige in the Communist world. While large quantity of Canadian grains have been sold to Red China, yet no people in the street have eaten or even heard of it. Will the Chinese Communists treat American grains in a different way and distribute it to the starving people? Certainly not. The American press are not unaware of this fact. Papers like the New York Mirror and the New York Daily News have already pointed out editorially that sale of food to Red China will only reinforce the power of the vicious tyranny which is now in crisis and prolong the sufferings of the mainland people. These are most significant opinions.

All the facts behind the Bamboo Curtain indicate that the Red regime is deeply resented by the people. If they know that the Americans are supplying food to their Red masters so that the tyrannical regime might survive, they will certainly feel disgusted.

Under such circumstances, we may easily realize that to sell food to the Reds is actually to strengthen the enemy. The needy people, however, will have no chance to be benefited. Only after the recovery of the Chinese mainland to the free world, the work of famine relief can be carried out in the true sense of the word.

We point out the importance of this matter in the hope that the American people

will not be fooled by few naive persons such as Pearl S. Buck and that the American Government will stand firmly opposing any kind of activities which will help the enemy.

Mr. Chairman, I think about every argument pro and con has been used in the debate on H.R. 10650.

As to the investment-tax credit, as far as I have heard from businessmen who have studied this proposal, it is a hand-out available to those who invest in tangible personal property and certain real property used in business such as blast furnaces and outdoor machinery.

It is odd that no industrialists or businessmen who stand to benefit have pressed for any such a credit. This benefit would be above the normal 100 percent depreciation on business assets which is allowed, and I wonder if business is not just a little embarrassed or suspicious to be in the position or on the receiving end of such a selective tax credit. Perhaps some persons guess it is political bait and wonder what eventual price they or others will be asked to pay for it.

According to the chairman of the Ways and Means Committee, this credit involves a loss to the Treasury in the form of tax income of \$1.175 million.

I have argued always that the business tax is too high, and I would support a general tax cut as against this special credit to certain favored taxpayers who are expanding or installing new facilities.

Actually, the fiscal picture of the country does not justify any tax reduction. Instead, we should be voting an increase in Federal revenue to offset the huge spending of this administration. We should be reducing the deficit and not increasing the national debt.

Here is the story:

On March 27, 1961, the President forecast a \$2.1 billion deficit in his budget.

On May 25, he said this deficit would be \$3.6 billion.

In July, the figure went up again. This time the President said the deficit would be \$5.3 billion.

On January 18, 1962, he came up with a new revised red figure of a \$7 billion deficit forecast.

Now, with 5 months to go until the end of the fiscal year, the estimate is for a \$9.4 billion deficit by June 30, 1962.

Congress has boosted the debt limit to \$300 billion because the Government is overspending. The President is asking an \$8 billion further increase in the legal debt limit.

The Treasury has estimated that, by imposing a withholding of 20 percent of interest on savings accounts and dividends payable, some of the tax credit windfall will be made up. I do not doubt that some revenue will be collected by this means that otherwise would be lost. However, I think the redtape and cost to corporations to achieve this revenue is unconscionable.

Therefore, I shall vote to recommit this bill to the committee under the motion which will be offered and which would require the committee to report it back to the House with the tax credit and withholding sections eliminated.

If the motion to recommit fails, as I suspect it will, then I shall vote against the bill on final passage. This is because in all conscience I cannot vote for legislation which will increase the deficit, not only next year, but in the years to come.

Mr. DADDARIO. Mr. Chairman, parts of this tax bill relating to the question of withholding on interest and dividend payments have raised a number of doubts in my mind concerning whether this system will not create more hardship than it will ease. While I recognize that the committee has done much to smooth this problem, it would seem to me that it can still interrupt a flow of cash income to those who earn it, and that such an interruption can work hardship on many who need to meet regular payments.

Aside from individuals who may be hurt, my attention has also been drawn to a specific problem relating to corporations. Although corporations subject to overwithholding also may claim quarterly refunds in addition to using a tax offset, there can be no question that this bookkeeping may involve a delay in the receipt and employment of cash income. When the House considered the Life Insurance Company Income Tax Act of 1959, it was noted that investment income is the principal source of such a tax. However companies must keep their funds constantly in productive use to build up this income, and a delay in the cash flow such as is proposed here would actually cause a loss to the Government in taxes by hobbling efforts to build that income.

I would like to pose a specific problem. Unfavorable underwriting results have placed one company in a position where it is not anticipated that Federal income tax will be paid over the next several years. However, withholding from the income on securities held in this company's portfolio would affect this company's position severely, as 20 percent of its dividend income amounts to about \$800,000 annually, or \$200,000 a quarter—obviously an important factor in its cash flow during the year. It is not a large company, and the offset would not meet its needs. While this company is in a position in which many other companies do not find themselves, it raises a question of whether such problems have been considered and whether, in fact, it is an unnecessary hardship to impose withholding of interest directed to institutional holders or corporations where extensive auditing makes certain that every cent of taxable income is reported under existing law. This injustice should be examined as this bill moves further toward enactment into law.

Mr. Chairman, it is with regret that I must offer opposition to this bill, H.R. 10650, although it contains several good provisions as to closing tax loopholes, but the people of my district have expressed opposition to this bill, especially the withholding tax on savings interest and dividends. I do not believe that the withholding on interest and dividends is a fair method of collecting tax because the tax reduces the amount of earned interest the taxpayer would have received because of the deductions every 3

months—this takes from him money on which he would otherwise be receiving interest.

It is my belief that the American taxpayer does not seek, in the majority, to defraud the Government and is agreeable to paying his fair share. Under the new system of identification numbers instituted by the Internal Revenue Service, any tax fraud or failure to report can easily be determined.

The tax bill benefits many large concerns which, I believe, if they wish to expand their operations could do so under present high profits.

There is nothing in this tax reform measure which would touch on our greatest source of additional revenue and which needs great revision, and that is the tax credits allowed for oil and mineral depletion. This remains at its high level of 27½ percent. I have introduced legislation relative to a more equitable tax plan for said depletion allowances.

If we are to benefit the economy of this Nation, we must start with the small taxpayer so that on this foundation can be built proper safeguards and tax revision.

(Mr. MILLS asked and was given permission to revise and extend his remarks.)

Mr. MILLS. Mr. Chairman, that concludes debate on the measure on this side.

The CHAIRMAN. All time for debate having expired, under the rule the bill is considered as having been read for amendment.

No amendments to the bill are in order except amendments offered by direction of the Committee on Ways and Means. Are there any committee amendments?

Mr. MILLS. Mr. Chairman, there are committee amendments. I offer the first committee amendment.

The Clerk read as follows:

Page 6, line 9, strike out "8" and insert: "7".

Page 6, line 15, strike out "\$100,000" and insert "\$25,000".

Page 6, line 16, strike out "50" and insert "25".

Page 6, line 17, strike out "\$100,000" and insert "\$25,000".

Page 7, line 15, strike out "\$50,000" and insert "\$12,500".

Page 7, line 15, strike out "\$100,000" and insert "\$25,000".

Page 7, line 21, strike out "\$100,000" and insert "\$25,000".

Page 7, line 24, strike out "\$100,000" and insert "\$25,000".

Page 10, line 4, strike out "50 percent" and insert "3/7".

Page 11, line 13, strike out "\$100,000" and insert "\$25,000".

Page 24, line 6, strike out "\$100,000" and insert "\$25,000".

Page 24, line 9, strike out "\$100,000" and insert "\$25,000".

The CHAIRMAN. The question is on the committee amendment.

The committee amendment was agreed to.

Mr. MILLS. Mr. Chairman, I offer another committee amendment.

The Clerk read as follows:

Committee amendment offered by Mr. MILLS: Page 51, strike out lines 13 through 23, and insert:

"(A) first out of its earnings and profits accumulated in taxable years beginning after December 31, 1951, to the extent thereof,

"(B) then out of the reserve for losses on qualifying real property loans, to the extent additions to such reserve exceed the additions which would have been allowed under subsection (b) (4),

"(C) then out of the supplemental reserve for losses on loans, to the extent thereof,

"(D) then out of such other accounts as may be proper.

"This paragraph shall apply in the case of any distribution in redemption of stock or in partial or complete liquidation of the association, except that any such distribution shall be treated as made first out of the amount referred to in subparagraph (B), second out of the amount referred to in subparagraph (C), third out of the amount referred to in subparagraph (A), and then out of such other accounts as may be proper."

Page 52, line 2, strike out "(A)" and insert "(B)".

Page 52, line 3, strike out "(B)" and insert "(C)".

Page 52, line 11, strike out "(1) (A)" and insert "(1) (B)".

Page 52, line 20, insert quotation marks after the period.

Page 52, strike out lines 21 to 24, inclusive.

DEFINITION OF "QUALIFIED LOAN"

Page 49, lines 18 to 20, strike out "any loan of the taxpayer secured by an interest in improved real property," and insert: "any loan secured by an interest in improved real property or secured by an interest in real property which is to be improved out of the proceeds of the loan."

Page 51, line 2, strike out "of the taxpayer".

DEFINITION OF "DOMESTIC BUILDING AND LOAN ASSOCIATION"

Page 55, lines 5 and 6, strike out "the second paragraph of".

Mr. MILLS (interrupting the reading of the committee amendment). Mr. Chairman, I ask unanimous consent that the further reading of this amendment be dispensed with. It was printed in the RECORD yesterday in connection with my remarks dealing with the section on savings and loan associations.

The CHAIRMAN. Is there objection to the request of the gentleman from Arkansas?

There was no objection.

The CHAIRMAN. The question is on the committee amendment.

The committee amendment was agreed to.

Mr. MILLS. Mr. Chairman, I offer some clerical amendments to correct certain clerical errors in the bills.

The Clerk read as follows:

Committee amendment offered by Mr. MILLS:

Page 42, line 16, strike out "522" and insert "552".

Page 89, line 13, strike out "(B)" and insert "(B))".

Page 150, line 12, strike out "954" and insert "955".

Mr. MILLS. Mr. Chairman, I would now like to comment briefly on the committee amendments which have been offered to the bill.

The series of committee amendments, in addition to certain clerical amendments, relate to two basic subjects—the investment credit provision contained in section 2, and the provisions contained in section 8 relating to mutual savings banks, savings and loan associations, and cooperative banks.

The first group of amendments, those related to the investment credit, have the following effect:

First. The amount generally allowable as a tax credit is reduced from 8 to 7 percent of the qualified investment.

Second. The amount available for most regulated public utilities as a tax credit is reduced from 4 to 3 percent of the qualified investment.

Third. The bill as reported limits the allowance of the tax credit to the full amount of the tax liability up to \$100,000 and to 50 percent of the liability in excess of \$100,000. The committee amendments reduce the amount of tax liability which may be fully offset by a tax credit from \$100,000 to \$25,000. They also provide that the credit may offset only 25 percent of the liability above \$25,000—instead of 50 percent above \$100,000. The amendments relating to mutual savings banks, savings and loan associations and cooperative banks relate to three subjects:

First, in the case of stock savings and loan associations, an amendment is made which is concerned with the priority of payments to stockholders of these associations. Under the bill as reported, distributions to stockholders are considered as being made first out of post-1962 reserves for losses on qualifying real property loans, then out of pre-1963 supplemental reserve for losses on loans. No taxes have been paid by the associations on amounts in these reserves, so taxes must be paid by the association at the time of the distributions. Only when these reserves are exhausted are distributions considered as being made out of earnings and profits accumulated since 1951 on which taxes have already been paid by the association. The committee amendments, in general, reverse the priority for these distributions to stockholders. They are first to be considered as made out of the tax paid earnings and profits accumulated since 1951 and only when these funds are exhausted will they be treated as paid out of reserves for losses on qualifying real property loans, and after that from the supplemental reserve for losses. The committee amendments retain the priority provided by the bill in the case of distributions in redemption of stock or in partial or complete liquidation of the association.

Second, the definition of qualified loans is expanded to include not only loans secured by an interest in improved real property but also loans secured by an interest in real property which is to be improved out of the proceeds of the loan. This merely carries out the initial intent of the committee as already is expressed in the committee report.

Third, the definition of a building and loan association is broadened to include those who make loans of the type permitted to be made by a Federal savings and loan association by any part of the section 5(c) of the Home Owners Loan Act and not merely by the second paragraph of that section 5(c).

Mr. Chairman, under leave to extend my remarks, I would like to insert at this point a summary of the bill as it would be amended by the committee amendments:

SUMMARY OF H.R. 10650, THE REVENUE ACT OF 1962 (INCLUDING EFFECT OF COMMITTEE AMENDMENTS)

Section 1. Short title, etc.: The act is to be cited as the "Revenue Act of 1962."

Section 2. Investment credit: Under the committee amendments, an investment credit against tax liability is provided. It generally is 7 percent (3 percent in the case of certain public utilities) of investments in new tangible personal property and most other depreciable real property except buildings and structural components of buildings. No credit is allowed for property with a useful life of less than 4 years. For property with a life of 4 to 6 years, one-third of the investment is taken into account; for property of 6 years to 8 years, two-thirds is taken into account; and for property with longer lives, the full amount of the investment is taken into account. Purchase of used property, up to \$50,000 worth, also is eligible for the credit. The credit may offset tax liability in full up to \$25,000, but above that point the credit may not reduce tax liability by more than 25 percent. Any unused credit may be carried over for 5 years and used in those years to the extent permissible under the applicable limitation. This provision is effective for taxable years ending after December 31, 1961, but only with respect to property acquired or to the extent constructed, reconstructed or erected after that date.

Section 3. Appearances with respect to legislation: A deduction is provided for costs relating to appearances before, presentation of statements to, or communications sent to a legislative body, a legislative committee or individual legislator, if the expenses are otherwise ordinary and necessary business expenses. A deduction also is allowed for the portion of dues paid to an organization which are used for similar legislative expenses to the extent they are related to the businesses of its members. In addition, the communication of information between the taxpayer and the organization with respect to legislation is deductible. This provision does not permit the deduction of expenses incurred for advertising or for attempts to influence the general public, or segments of the public, or for expenses concerned with political campaigns. This provision applies to taxable years beginning after December 31, 1962.

Section 4. Entertainment expenses: Deductible expenses for entertainment, amusement or recreation generally are limited to those directly related to the active conduct of a trade or business and in the case of facilities, a further restriction is imposed to the effect that the facility must be used primarily for the furtherance of the taxpayer's trade or business. An exception to this limitation is provided for business meals where the surroundings are such as to be conducive to a business discussion. Eight other specific exceptions also are provided. A second feature of the provision limits the deduction for business gifts to \$25 per year per individual recipient. In a third feature of the provision, rules are set forth providing that the deduction of entertainment or travel expenses will be denied unless they are substantiated as to amount, time and place, business purpose and business relationship to the taxpayer of the persons involved. Fourth, in the case of traveling expenses, only a reasonable allowance for amounts spent for meals and lodging is to be deductible rather than the entire amount so spent. This provision applies to taxable years ending after June 30, 1962, for periods after that date.

Section 5. Distributions in kind by a foreign corporation: Distributions in kind from foreign corporations to domestic corporations are treated as having a value equal to the fair market value of the property distributed (and not the adjusted basis of this

property in the hands of the distributing corporation where this is lower). This applies to distributions made after December 31, 1962.

Section 6. Allocation of income in the case of sales to or from a foreign corporation: Where goods are purchased or sold by a domestic corporation to a related foreign corporation, the taxable income arising from these transactions is to be allocated between the parties on the basis of the location of the assets used in the operations, the payroll attributable to them and the related selling expenses. Other factors may also be taken into account. This rule is not to apply where an arm's length price can be established by the taxpayer for the purchases or sales. Sales commissions of a related corporation are to be treated under similar rules. This is effective for taxable years beginning after December 31, 1962.

Section 7. Foreign personal holding companies: At present, the entire income of a foreign personal holding company is taxed to the U.S. shareholders if 60 percent (50 percent after the first year) or more of its income is from passive sources (such as interest, royalties, and dividends). The bill provides that if 20 percent or more of the income is from these passive sources, then the passive portion of the income is to be taxed to the U.S. shareholders and if more than 80 percent of the income is from these passive sources, then the entire income is to be taxed to the U.S. shareholders (to the extent of their holdings). This applies to taxable years beginning after December 31, 1962.

Section 8. Mutual savings banks, etc.: Mutual savings banks, domestic building and loan associations and cooperative banks under present law are allowed to add all of their income to bad debt reserves until reserves reach 12 percent of deposits. In lieu of this, they are to be permitted deductions for additions to bad debt reserves generally of up to 60 percent of their taxable income (before this deduction) or, if larger, an amount bringing their reserves up to 3 percent of improved real property loans, plus a reasonable addition for other loans (existing reserves in excess of this amount are disregarded).

Under the committee amendments in the case of stock savings and loan associations, distributions to shareholders will be considered as paid first out of already tax-paid funds and, only when these are exhausted, out of reserve funds on which a tax has to be paid by the association at the time of distribution. Also, under the committee amendments a domestic building and loan association is defined as one which is insured under the National Housing Act or subject to State or Federal supervision but only if substantially all of its business consists of accepting savings and investing the loans in residential real property or in loans authorized for a Federal savings and loan association under section 5(c) of the Home Owners Loan Act. In addition, the exemption for Federal savings and loan associations from the excise taxes on communications and transportation of persons is repealed.

Generally, these provisions are effective for taxable years ending after December 31, 1962. The excise tax changes, however, are effective as of June 30, 1962.

Section 9. Distributions by foreign trusts: Distributions by foreign trusts established by U.S. grantors (or added to by U.S. transferors) are to be taxed to any U.S. beneficiaries in substantially the same manner as if the beneficiaries had received this income directly in the year earned rather than later when the distribution is made. However, the additional tax is payable at the time of the actual distribution. For those preferring not to make the calculations required under this exact method of taxation, an averaging device is provided. This applies to dis-

tributions made in taxable years beginning after the date of enactment of the bill.

Section 10. Mutual fire and casualty insurance companies: Mutual fire and casualty insurance companies are to be taxed on their total income less a deduction for additions to a reserve for protection against losses equal to one-fourth of their underwriting gains plus 1 percent of their insurance claims. After a 5-year interval, the 1 percent set aside with respect to insurance claims and one-half of the amount attributable to underwriting gains is brought back into the taxable income to the extent not already offset by losses. The remainder, to the extent not offset by losses, will remain in the loss reserve but no amount may be added to this reserve which would build it up to a level of more than 10 percent of the current year's premiums. Companies whose total receipts do not exceed \$75,000 are to remain exempt from tax, and companies with total receipts of between \$75,000 and \$300,000 will be taxed only on their investment income. For those with gross receipts above \$300,000, a special deduction of \$6,000 is provided which decreases as gross receipts rise and disappears at a level of gross receipts of \$900,000. Factory mutual companies are to be taxed like stock companies without the special reserve referred to above. However, in computing their underwriting profits they will be permitted to determine their premium income on the basis of "absorbed" premium deposits (i.e. in general, excluding the portion of the deposit returnable to the person insured). The amount so determined is then increased by 2 percent. Reciprocal underwriters and interinsurers are in effect permitted to combine the underwriting income of their corporate attorney in fact with their own for purposes of offsetting losses but not for the purposes of computing additions to their loss reserve. These provisions apply to taxable years beginning after December 31, 1962.

Section 11. Domestic corporations receiving dividends from foreign corporations: Where a domestic corporation receives a dividend from a foreign corporation, the amount included in its tax base, if it elects the foreign tax credit, is to be not only the dividend itself but also the tax paid by the foreign corporations as well. Also, where a foreign corporation is eligible for the 85 percent intercorporate dividends received deduction with respect to income earned in the United States, the 15 percent of this income for which no deduction is allowed is not to be treated as foreign source income for purposes of the foreign tax credit. The subsection of present law making the foreign tax credit available for royalty income received from wholly owned subsidiaries in certain cases is repealed. These amendments become fully effective for distributions received by domestic corporations after December 31, 1964. In the case of distributions received by domestic corporations before 1965 but in taxable years after December 31, 1962, the new rules are to apply in the case of distributions made out of profits of a foreign corporation accumulated in taxable years beginning after December 31, 1962.

Section 12. Earned income from sources outside the United States: Under existing law individuals who are present in a foreign country or countries for 17 out of 18 months may exclude from their U.S. tax base up to \$20,000 per year of income earned abroad. If they are bona fide residents of a foreign country there is no ceiling on this exclusion. In the case of these bona fide foreign residents, a ceiling is to be provided of \$20,000 for the first 3 years they are abroad and \$35,000 thereafter. In addition, contributions made by employers for employee benefits under qualified plans with respect to future employment are to be tax-

able to the employee when he receives these amounts after retirement. Generally these provisions are effective with respect to taxable years ending after December 31, 1962.

Section 13. Controlled foreign corporations: In the case of controlled foreign corporations, where more than 50 percent of the stock is owned by U.S. persons, U.S. shareholders who own 10 percent or more of the stock in these corporations are to report for tax purposes the undistributed earnings of these corporations to the extent they represent: (a) income from insuring or reinsuring U.S. risks; (b) income from patents, copyrights, and exclusive formulas or processes developed in the United States or acquired here from related persons; (c) passive types of income; and (d) income from purchases or sales with related persons where the goods are produced or grown and the property is sold for use outside of the country of incorporation of the foreign corporation involved. In these latter two cases, the combination of the two types of income must equal 20 percent of total income before it is taken into account (and sales income must equal 20 percent of income other than the passive income to be taken into account). Where this combined income equals more than 80 percent of the total, then all income is attributed to the shareholders. However, reductions in the income taxed to shareholders are allowed in these two latter cases to the extent the income is invested in active business in less developed countries, where the corporation in which the investment is made is, to the extent of 50 percent or more, owned by 5 or fewer U.S. persons, but only if the taxpayer has at least a 10 percent interest.

To the extent the 10 percent U.S. shareholders are not taxed on the income of the controlled foreign corporation under the provisions described above, they are to be subject to taxation on the undistributed earnings of the controlled foreign corporation to the extent these earnings are not invested in substantially the same trade or business as that in which the taxpayer was engaged for the prior 5 years (or on December 31, 1962), or invested in less developed countries in new trades or businesses or in the controlled subsidiaries, 50 percent or more of which is held by 5 or fewer U.S. persons. The 50 percent test referred to above is relaxed where the foreign country prohibits ownership by Americans and others of as much as 50 percent of the stock of a corporation established under their laws.

Undistributed earnings which are taxed to the U.S. shareholders under any of the above provisions may be actually distributed to U.S. shareholders without further payment of tax. These provisions apply to taxable years of foreign corporation beginning after December 31, 1962, and to taxable years of U.S. persons falling in such years.

Section 14. Ordinary income on certain gains from depreciable property: In the case of personal property and most real estate, other than buildings and structural components, when such property is sold or exchanged at a gain, this gain, to the extent of depreciation taken for taxable years beginning after December 31, 1961, is to be treated as ordinary income for tax purposes. In the case of dispositions of property other than by sale or exchange this same treatment is to apply except that the amount of the presumed gain is to be determined by the excess of the fair market value of the property at the time of its disposition over its then adjusted basis.

This treatment is to apply in the case of most dispositions of property whether or not gain is otherwise recognized. The treatment described above does not apply, however, in the case of gifts although in the case of charitable contributions the amount of the charitable contribution deduction which may be taken is reduced by the amount which

would be treated as ordinary income if this provision were applicable. Other exceptions are provided for property transferred by death, for transfers where no gain is recognized and the basis of the property is carried over to the transferor, and for transfers in like kind exchanges and involuntary conversions to the extent no gain is recognized. In the case of partnerships, distributions to partners or sales of partnership interests are taxed to the partners to the extent of the underlying depreciable property in much the same way as if the depreciable property had been sold directly.

The bill also provides that in computing the basis on which depreciation may be taken salvage value may be ignored to an amount equal to 10 percent of the cost or other basis of the property. Also, under the bill taxpayers are permitted to elect after this bill is enacted to change their method of depreciation with respect to property coming within the scope of this provision from any declining balance, or sum-of-the-years digit method to a straight-line method.

This provision applies to taxable years beginning after December 31, 1961, and ending after the date of enactment of this bill.

Section 15. Foreign investment companies: When stock in foreign investment companies is sold, the gain realized by the U.S. shareholders is to be ordinary income to the extent of the earnings and profits of the corporation accumulated in taxable years beginning after December 31, 1962. In the case of stock in a foreign investment company acquired from a decedent, the basis of the stock is not to be increased at the date of death to the extent of the amount which would have been taxed as ordinary income to the decedent had he sold the stock before death. A deduction for estate tax attributable to this amount will be allowed, however, upon subsequent sale of this stock by the heir or legatee.

The companies and shareholders can avoid the treatment described above if the companies distribute 90 percent or more of their taxable income, other than capital gains, designate in a written notice to the shareholders each year their ratable share of the capital gains of the corporation and provide such other information as the Treasury requires to enforce this provision. The shareholders, however, must also report as capital gains their share of the capital gains of the corporation, whether the gains are distributed or not.

These provisions apply with respect to taxable years beginning after December 31, 1962.

Section 16. Gain from sales or exchanges of stock in foreign corporations: Where there is a redemption or liquidation of the stock of a controlled foreign corporation or where stock in such a corporation is sold, then any gain to the extent it represents earnings and profits of the corporation accumulated abroad is to be taxed to 10-percent U.S. shareholders as ordinary income or as dividends. In the case of the redemptions and liquidations, the earnings and profits taken into account are those accumulated since February 28, 1913. In this case, a foreign tax credit is to be allowed corporate shareholders for taxes paid to foreign countries. In the case of sales and other exchanges, the earnings and profits taken into account with respect to any shareholder is his share of profits accumulated during the period in which he held the stock. In this case, no foreign tax credit is available. These provisions apply with respect to sales or exchanges occurring after the date of enactment of this bill. This applies to sales, etc., after the enactment of this bill.

Section 17. Tax treatment of cooperatives and patrons: Cooperatives are to receive a deduction for patronage dividends paid to their patrons in cash or by allocations if the

patron has the option to redeem the notices of allocation in cash for a 90-day period after they are issued or if he consents to this income being treated as constructively received by him and then reinvested in the cooperative. The patron may give his consent individually in writing or the cooperative may through its bylaws require all members (after notification) to give this consent. In the case of allocations which do not qualify, the cooperative will initially be taxed on this type of patronage dividends. However, when such a patronage dividend is redeemed, the cooperative will receive a deduction (or refund of tax) at that time.

Where consent is given, or where the option to receive cash was available, the patron will be required to pay taxes on the patronage dividends which arise from business activity. The patron will also be required to take into account nonqualifying patronage dividends when they are redeemed (assuming they arise from business activity).

In addition, all cooperatives (rather than merely tax-exempt cooperatives as under present law) are given until 8½ months after the end of the year in which patronage occurs to allocate amounts to the accounts of their patrons and in most cases are also given this same period of time for the filing of their own income tax returns. These provisions apply to taxable years of cooperatives beginning after December 31, 1962, and with respect to amounts received by patrons attributable to years of the cooperatives to which the new law applies. The new provisions will not, however, apply to future redemptions of patronage dividends declared when the old law was applicable.

Section 18. Inclusion of foreign real property in gross estate: Real property located outside of the United States, in the case of citizens or residents of the United States, is to be included in their tax base for purposes of the Federal estate tax imposed at the time of their death. This provision will be fully effective for decedents dying on or after July 1, 1964. For those dying after the date of enactment of this bill, and before July 1, 1964, real property located outside of the United States will be included in their gross estate only if acquired on or after February 1, 1962.

Section 19. Withholding of tax on interest, dividends and patronage dividends: Withholding at the source is provided for dividends, most interest and patronage dividends at a rate of 20 percent. No receipts are required to be given by the payors to the taxpayers under this system and no significant change is made in the information returns which presently must be filed by the payors with the Federal Government.

No withholding is to occur in the case of dividends, savings account interest, or Government series E bond interest if the recipient files an exemption certificate indicating that he is under age 18. These exemption certificates may also be filed (but on an annual basis) by those over age 18 with respect to any year in which they reasonably expect to have no income tax liability. Claims for quarterly refunds may also be filed by individuals where there is expected to be significant amounts of overwithholding of their tax liability. Corporations and tax-exempt organizations may also file for quarterly refunds. In addition, corporations may claim credits on their dividend or interest payments for amounts withheld with respect to dividend or interest payments they receive. Tax-exempt organizations may also claim credits with respect to amounts withheld on the dividend and interest payments they receive against wage and salary withholding on their employees for income tax and social security tax liability.

Generally these provisions apply in the

case of interest and dividends paid on or after January 1, 1963.

Section 20. Information with respect to foreign entities: A number of changes are made in the annual information return which domestic corporations presently are required to file with respect to their subsidiaries or foreign corporations which they control. The changes are: this return is to be filed not only by corporations but by others as well which control foreign corporations; "control" is defined more broadly by adding certain constructive ownership rules; information must be provided not only with respect to subsidiaries of foreign corporations but also for other foreign corporations which are further down the chain of ownership; and additional information may be required which is similar or related in nature to that already specified.

Present law also requires U.S. citizens or residents who are officers or directors of a foreign corporation within 60 days of its organization or reorganization and also 5-percent shareholders who have this status within 60 days of the organization or reorganization to supply certain information to the Treasury Department with respect to the corporation. This same information is also to be required of U.S. citizens or residents who at some later time become officers, directors or shareholders with an interest of 5 percent or more. A penalty provision also is provided.

Generally these additional information requirements become effective as of January 1, 1963.

Section 21. Treaties: It is made clear that any provision contained in this bill is intended to have precedence over any prior tax treaty obligation.

The CHAIRMAN. The question is on the committee amendment.

The committee amendment was agreed to.

The CHAIRMAN. Are there any further amendments?

Mr. MILLS. There are no further amendments, Mr. Chairman.

The CHAIRMAN. Under the rule, the Committee rises.

Accordingly, the Committee rose; and the Speaker having resumed the chair, Mr. ROOSEVELT, Chairman of the Committee of the Whole House on the State of the Union, reported that that Committee having had under consideration the bill (H.R. 10650) to amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes, pursuant to House Resolution 576, he reported the bill back to the House with sundry amendments adopted by the Committee of the Whole.

The SPEAKER. Under the rule, the previous question is ordered.

Is a separate vote demanded on any amendment? If not, the Chair will put them en gros.

The amendments were agreed to.

The SPEAKER. The question is on the engrossment and third reading of the bill.

The bill was ordered to be engrossed and read a third time and was read the third time.

Mr. BYRNES of Wisconsin. Mr. Speaker, I offer a motion to recommit.

The SPEAKER. Is the gentleman opposed to the bill?

Mr. BYRNES of Wisconsin. I am, Mr. Speaker.

The SPEAKER. The Clerk will report the motion to recommit.

The Clerk read as follows:

Mr. BYRNES of Wisconsin moves to recommit the bill (H.R. 10650) to the Committee on Ways and Means with instructions to report the same back to the House forthwith with the following amendment: Strike out section 2 and section 19 of the bill.

The SPEAKER. The question is on the motion to recommit.

Mr. BYRNES of Wisconsin. Mr. Speaker, on that I demand the yeas and nays.

The yeas and nays were ordered.

The question was taken; and there were—yeas 190, nays 225, answered "present" 0, not voting 21, as follows:

[Roll No. 51]

YEAS—190

Abbott	Fallon	Moore
Abernethy	Feighan	Moorehead,
Adair	Fenton	Ohio
Addabbo	Findley	Morse
Alford	Fino	Mosher
Alger	Fisher	Natcher
Andersen,	Ford	Nelsen
Minn.	Frelinghuysen	Norblad
Anderson, Ill.	Fulton	O'Konski
Arends	Garland	Osmer
Ashbrook	Gavin	Ostertag
Auchincloss	Glenn	Pelly
Avery	Goodell	Pike
Ayres	Goodling	Pillion
Baker	Grant	Pirnie
Baldwin	Griffin	Poff
Barry	Gross	Quie
Bass, N.H.	Gubser	Ray
Battin	Hagen, Calif.	Reece
Becker	Haley	Reifel
Beckworth	Hall	Rhodes, Ariz.
Beermann	Halleck	Riehlman
Belcher	Halpern	Robison
Bell	Harrison, Wyo.	Rogers, Colo.
Berry	Harsha	Rogers, Fla.
Betts	Harvey, Ind.	Roudebush
Bolton	Harvey, Mich.	Roussellot
Bow	Hays	St. George
Bray	Hiestand	Saylor
Bromwell	Hoeven	Schadeberg
Broomfield	Hoffman, Ill.	Schenck
Brown	Horan	Scherer
Broyhill	Hosmer	Schneebeli
Bruce	Joelson	Schweiker
Byrnes, Wis.	Johansen	Schwengel
Cahill	Jonas	Scranton
Cannon	Judd	Seely-Brown
Casey	Keith	Shriver
Cederberg	Kilburn	Sibal
Chamberlain	King, N.Y.	Siler
Chenoweth	Knox	Smith, Calif.
Chiperfield	Kunkel	Smith, Va.
Church	Kyl	Springer
Clancy	Laird	Stafford
Collier	Langen	Taber
Conte	Latta	Teague, Calif.
Cook	Lindsay	Thomson, Wis.
Corbett	Lipscomb	Utt
Cramer	McCulloch	Vanik
Cunningham	McDonough	Van Pelt
Curtin	McIntire	Van Zandt
Curtis, Mass.	McVey	Waggonner
Curtis, Mo.	MacGregor	Wallhauser
Dague	Mailliard	Weaver
Derounian	Martin, Mass.	Weis
Derwinski	Martin, Nebr.	Westland
Devine	Mathias	Whalley
Dole	May	Wharton
Dominick	Meador	Whitten
Dooley	Merrow	Widnall
Dowdy	Michel	Williams
Durno	Miller, N.Y.	Wilson, Calif.
Dwyer	Milliken	Winstead
Ellsworth	Minshall	Younger

NAYS—225

Addonizio	Blatnik	Burke, Mass.
Albert	Blitch	Burleson
Alexander	Boggs	Byrne, Pa.
Anfuso	Boland	Carey
Ashley	Bolling	Celler
Ashmore	Bonner	Chelf
Aspinall	Boykin	Clark
Bailey	Brademas	Coad
Baring	Breeding	Cohelan
Barrett	Brewster	Cooley
Bass, Tenn.	Buckley	Corman
Bennett, Fla.	Burke, Ky.	Daddario

Daniels	Jones, Ala.	Philbin
Davis,	Jones, Mo.	Pilcher
James C.	Karsten	Poage
Davis, John W.	Karth	Powell
Davis, Tenn.	Kastenmeier	Price
Dawson	Kee	Pucinski
Delaney	Kelly	Purcell
Dent	Keogh	Randall
Denton	Kilgore	Reuss
Diggs	King, Calif.	Rhodes, Pa.
Donohue	King, Utah	Rivers, Alaska
Dorn	Kirwan	Rivers, S.C.
Downing	Kitchin	Roberts, Tex.
Doyle	Kluczynski	Rodino
Dulski	Kornegay	Rogers, Tex.
Edmondson	Kowalski	Rooney
Elliott	Landrum	Roosevelt
Everett	Lane	Rosenthal
Evins	Lankford	Rostenkowski
Farbstein	Lennon	Roush
Fascell	Lesinski	Rutherford
Finnegan	Libonati	Ryan, N.Y.
Flood	Loser	Ryan, Mich.
Flynt	McDowell	St. Germain
Fogarty	McFall	Santangelo
Forrester	McMillan	Saund
Fountain	McSweeney	Scott
Frazier	Macdonald	Shelley
Friedel	Mack	Shipley
Gallagher	Madden	Sikes
Garmatz	Magnuson	Sisk
Gary	Mahon	Slack
Gathings	Marshall	Smith, Iowa
Gialmo	Matthews	Smith, Miss.
Gilbert	Miller, Clem	Spence
Gonzalez	Miller,	Staggers
Granahan	George P.	Steed
Gray	Mills	Stephens
Green, Oreg.	Moeller	Stratton
Green, Pa.	Monagan	Stubblefield
Griffiths	Montoya	Sullivan
Hagan, Ga.	Moorhead, Pa.	Taylor
Hansen	Morgan	Teague, Tex.
Harding	Morris	Thomas
Hardy	Morrison	Thompson, La.
Harris	Moss	Thompson, N.J.
Harrison, Va.	Moulder	Thompson, Tex.
Healey	Multer	Thornberry
Hebert	Murphy	Toll
Hechler	Murray	Trimble
Hemphill	Nedzi	Tuck
Henderson	Nix	Udall, Morris K.
Herlong	Norrell	Ullman
Hollifield	O'Brien, Ill.	Vinson
Holland	O'Brien, N.Y.	Watts
Huddleston	O'Hara, Ill.	Whitener
Hull	O'Hara, Mich.	Wickersham
Ichord, Mo.	Olsen	Willis
Inouye	O'Neill	Wright
Jarman	Passman	Yates
Jennings	Patman	Young
Johnson, Calif.	Perkins	Zablocki
Johnson, Md.	Peterson	Zelenko
Johnson, Wis.	Pfost	

ANSWERED "PRESENT"—0

NOT VOTING—21

Andrews	Jensen	Sheppard
Bates	Kearns	Short
Bennett, Mich.	Mason	Tollefson
Brooks	Nygaard	Tupper
Colmer	Rains	Walter
Dingell	Roberts, Ala.	Wilson, Ind.
Hoffman, Mich.	Selden	

So the motion to recommit was rejected.

The Clerk announced the following pairs:

On this vote:

Mr. Colmer for, with Mr. Brooks against.

Mr. Walter for, with Mr. Dingell against.

Mr. Short for, with Mr. Sheppard against.

Until further notice:

Mr. Andrews with Mr. Tupper.

Mr. Rains with Mr. Wilson of Indiana.

Mr. Roberts of Alabama with Mr. Bates.

Mr. Selden with Mr. Jensen.

The result of the vote was announced as above recorded.

The SPEAKER. The question is on the passage of the bill.

Mr. BYRNES of Wisconsin. Mr. Speaker, on that I demand the yeas and nays.

The yeas and nays were ordered.

The question was taken; and there were—yeas 219, nays 196, not voting 21, as follows:

[Roll No. 52]

YEAS—219

Abbott	Grant	Nedzi
Addonizio	Gray	Nix
Albert	Green, Oreg.	Norrell
Alexander	Green, Pa.	O'Brien, Ill.
Anfuso	Griffiths	O'Brien, N.Y.
Ashley	Hagan, Ga.	O'Hara, Ill.
Ashmore	Hansen	O'Hara, Mich.
Aspinall	Hardy	Olsen
Bailey	Harris	O'Neill
Baring	Harrison, Va.	Passman
Barrett	Healey	Patman
Bass, Tenn.	Hébert	Perkins
Beckworth	Hechler	Peterson
Bennett, Fla.	Hemphill	Pfost
Blatnik	Henderson	Philbin
Blitch	Herlong	Pilcher
Boggs	Hollifield	Poage
Boland	Holland	Poff
Bolling	Huddleston	Powell
Bonner	Hull	Price
Boykin	Ichord	Pucinski
Brademas	Inouye	Purcell
Brewster	Jarman	Reuss
Buckley	Jennings	Rhodes, Pa.
Burke, Ky.	Johnson, Calif.	Rivers, Alaska
Burke, Mass.	Johnson, Md.	Rivers, S.C.
Burleson	Johnson, Wis.	Roberts, Tex.
Byrne, Pa.	Jones, Ala.	Rodino
Cannon	Jones, Mo.	Rooney
Carey	Karsten	Roosevelt
Celler	Karth	Rosenthal
Chelf	Kastenmeier	Rostenkowski
Clark	Kee	Roush
Coad	Kelly	Ryan, Mich.
Cohelan	Keogh	Ryan, N.Y.
Cooley	Kilgore	St. Germain
Corman	King, Calif.	Santangelo
Daddario	King, Utah	Saund
Daniels	Kirwan	Scott
Davis,	Kitchin	Shelley
James C.	Kluczynski	Sikes
Davis, John W.	Kornegay	Sisk
Davis, Tenn.	Kowalski	Slack
Dawson	Landrum	Smith, Iowa
Delaney	Lane	Smith, Miss.
Dent	Lankford	Smith, Va.
Denton	Lennon	Spence
Diggs	Lesinski	Steed
Donohue	Libonati	Stephens
Dorn	Loser	Stratton
Downing	McFall	Stubblefield
Doyle	McSweeney	Sullivan
Edmondson	Macdonald	Teague, Tex.
Elliott	Mack	Thomas
Everett	Madden	Thompson, La.
Evins	Magnuson	Thompson, N.J.
Farbstein	Mahon	Thompson, Tex.
Fascell	Matthews	Thornberry
Finnegan	Miller, Clem	Toll
Flood	Miller,	Trimble
Flynt	George P.	Tuck
Fogarty	Mills	Udall
Forrester	Moeller	Ullman
Fountain	Monagan	Vinson
Frazier	Montoya	Watts
Friedel	Moorhead, Pa.	Whitener
Gallagher	Morgan	Wickersham
Garmatz	Morris	Willis
Gary	Morrison	Wright
Gathings	Moss	Yates
Gialmo	Moulder	Young
Gilbert	Multer	Zablocki
Gonzalez	Murphy	Zelenko
Granahan	Murray	

NAYS—196

Abernethy	Bromwell	Dominick
Adair	Broomfield	Dooley
Addabbo	Brown	Dowdy
Alford	Broyhill	Dulski
Alger	Bruce	Durno
Andersen,	Byrnes, Wis.	Dwyer
Minn.	Cahill	Ellsworth
Anderson, Ill.	Casey	Fallon
Arends	Cederberg	Feighan
Ashbrook	Chamberlain	Fenton
Auchincloss	Chenoweth	Findley
Avery	Chiperfield	Fino
Ayres	Church	Fisher
Baker	Clancy	Ford
Baldwin	Collier	Frelinghuysen
Barry	Conte	Fulton
Bass, N.H.	Cook	Garland
Battin	Corbett	Gavin
Becker	Cramer	Glenn
Beermann	Cunningham	Goodell
Belcher	Curtin	Goodling
Bell	Curtis, Mass.	Griffin
Berry	Curtis, Mo.	Gross
Betts	Dague	Gubser
Bolton	Derounian	Hagen, Calif.
Bow	Derwinski	Haley
Bray	Devine	Hall
Breeding	Dole	Halleck

Halpern	Mathias	Saylor
Harding	May	Schadeberg
Harrison, Wyo.	Meader	Schenck
Harsha	Merrrow	Scherer
Harvey, Ind.	Michel	Schneebell
Harvey, Mich.	Miller, N.Y.	Schweiker
Hays	Milliken	Schwengel
Hiestand	Minshall	Scranton
Hoeven	Moore	Seely-Brown
Hoffman, Ill.	Moorehead,	Shipley
Horan	Ohio	Shriver
Hosmer	Morse	Sibal
Joelson	Mosher	Siler
Johansen	Natcher	Smith, Calif.
Jonas	Nelsen	Springer
Judd	Norblad	Stafford
Keith	O'Konski	Staggers
Kilburn	Osmers	Taber
King, N.Y.	Ostertag	Taylor
Knox	Pelly	Teague, Calif.
Kunkel	Pike	Thompson, Wis.
Kyl	Pillion	Utt
Laird	Pirnie	Vanik
Langen	Quie	Van Pelt
Latta	Randall	Van Zandt
Lindsay	Ray	Waggonner
Lipscomb	Reece	Wallhauser
McCulloch	Reifel	Weaver
McDonough	Rhodes, Ariz.	Weiss
McDowell	Riehlman	Westland
McIntire	Robison	Whalley
McMillan	Rogers, Colo.	Wharton
McVey	Rogers, Fla.	Whitten
MacGregor	Rogers, Tex.	Widnall
Mailliard	Roudebush	Williams
Marshall	Rousselot	Wilson, Calif.
Martin, Mass.	Rutherford	Winstead
Martin, Nebr.	St. George	Younger

NOT VOTING—21

Andrews	Jensen	Sheppard
Bates	Kearns	Short
Bennett, Mich.	Mason	Tollefson
Brooks	Nygaard	Tupper
Colmer	Rains	Walter
Dingell	Roberts, Ala.	Wilson, Ind.
Hoffman, Mich.	Selden	

So the bill was passed.

The Clerk announced the following pairs:

On this vote:

Mr. Brooks for, with Mr. Colmer against.
Mr. Dingell for, with Mr. Walter against.
Mr. Sheppard for, with Mr. Short against.
Mr. Rains for, with Mr. Bates against.
Mr. Roberts for, with Mr. Tollefson against.

Until further notice:

Mr. Andrews with Mr. Wilson of Indiana.
Mr. Selden with Mr. Jensen.

The result of the vote was announced as above recorded.

A motion to reconsider was laid on the table.

GENERAL LEAVE TO EXTEND

Mr. MILLS. Mr. Speaker, I ask unanimous consent that Members desiring to do so have 5 legislative days to extend their remarks in the RECORD on the bill just passed.

The SPEAKER. Is there objection to the request of the gentleman from Arkansas?

There was no objection.

Mr. MILLS. Mr. Speaker, I ask unanimous consent that those Members speaking on the bill be permitted to include extraneous material, such as charts and tables, with their remarks.

The SPEAKER. Is there objection to the request of the gentleman from Arkansas?

There was no objection.

REVENUE ACT OF 1962

Mr. RANDALL. Mr. Speaker, under the closed rule which was sustained by

the vote of the House, it was quite apparent that only very few Members could be allotted time to participate in debate with only a total of 8 hours divided equally between the minority and the majority. This meant that most of the membership would be limited to extending their remarks in the RECORD so that there could be preserved a record of the reasons for the votes which were taken.

We supported the closed rule. Like many Members we are against the closed or gag rule in principle, but recognize where there is a legislative body the size of the House of Representatives, it becomes almost a procedural necessity. Yet, just a few short weeks ago, there were those who wanted to increase the size of the House. When the committee has had almost a year to consider the provisions of the bill and then the membership is given a total of 8 hours to debate the bill, without the right of amendment by Members other than those of the Committee on Ways and Means, this seems like cloture that should not exist, and yet, objectionable as the closed rule is in principle, it becomes a necessity to maintain orderly procedure on such a controversial measure. There are instances in the older RECORDS of the House that where a revenue measure came before the body under an open rule permitting unlimited debate, the story goes, the argument continued on for months and in desperation the weary Members finally recommitted the bill as the only way to terminate debate.

The next vote by yeas and nays was on the motion to recommit offered by the minority pursuant to the terms of the closed rule. We voted against the motion to recommit for the reason that it was not a simple motion to recommit but instead, one with instructions. Section 2, the credit for investment in certain depreciable property was stricken in its entirety and also section 19, the withholding of income tax at source on interest, dividends, and patronage dividends was stricken. We could not support such a limited motion for the reason that to take these two provisions only out of the bill, or to simply lift these two provisions in their entirety from the bill without any effort whatsoever to improve or to modify for the better the other deficiencies was not acceptable.

And what is also true is that to remove only section 2 and section 19 and allow the rest of the bill to stand sets the bill up as a purely revenue-producing bill without much, if any, effort to correct tax inequities. To be blunt, it is a tax increase bill by disallowing entertainment expenses, on raising the rates on mutual savings banks, and mutual insurance companies and from such sources as requiring the payment of tax by domestic corporations receiving dividends from foreign corporations. Also, left in the bill by the limited motion to recommit was the increase in the gains from the disposition of depreciable property as well as the change in tax treatment of cooperatives. We could not join in such a motion to recommit con-

taining only such limited instructions for reasons we will hereinafter set forth.

As we have written repeatedly to our constituents, when a closed rule is adopted and there is allowed only one motion to recommit with no amendments permitted by the membership except only committee amendments, the issue concerns a package and under such a parliamentary situation, the burden is on each member to carefully weigh the good against the bad as to this package—the desirable against the unacceptable—the favorable against the objectionable. Does the good and bad balance out evenly? Is it 51 to 49 percent, 55 to 45 percent, 60 to 40 percent, or 65 to 35 percent, or just what percent is good and what percent is bad? No one can say. In matters of legislation such mathematical certainty cannot be achieved. But if there is any more bad than there is good in the bill, then the bill should not be supported on final passage.

And at this point, Mr. Speaker, we should point out there are two paths to follow—one is, that if the good in the package is almost as large a quantity as the bad, a Member should vote for the measure on final passage to send the bill to the Senate in the hope that the Senate will improve the bill, or as it is sometimes put, "clean it up," which means improvement, simplification, or some betterment in the bill. But it must be emphasized that this is always relying upon just a hope or faith that the other body will make improvements. The other path demands of us that we cannot proceed upon such a premise because by doing so we avoid our responsibility as Members of the House and shift the burden wholly to the Senate. It is for this reason that we voted "no" on H.R. 10650 on final passage. As it turned out the bill was approved by the House and does go to the Senate, and if there are changes made by the Senate to where it can be made acceptable, those of us who opposed it on final passage may have the opportunity to support the measure after it returns from conference.

Mr. Speaker, we wish to make it very plain that we are not against anything just for the sake of being negative. We are certainly not against the tightening of tax loopholes which we thought was one of the original purposes of the bill, and we are certainly not against any equitable provision which would have raised revenue, because we had thought that such was one of the principal and paramount purposes of this measure. And we are not against the tax credit for investment as a principle. We like to believe that we are moderate in our approach to most legislation. But here we are dealing with a bill which is cited as the Revenue Act of 1962, and I had thought we were all most interested in a balanced budget. My point is, that if the principle of investment credit is good, then let us be sure and certain that it is going to work and I would have hoped that as to this provision the committee would have been a little more conservative. By this I mean there should be

nothing sacred or even magical about the figure of 8 percent or 7 percent. My present belief is that we should have tried a 2- or 3-percent credit as a trial to find out or first determine the amount of response from industry. Or if the larger investment credit were set up, then provide for a trial period of from 2 to 3 years, rather than setting this provision up suddenly and all at once as a permanent part of our tax structure and allowing this tax credit for investments to recur year after year, until it could be reevaluated in the light of actual experience.

I am certain every member of the Ways and Means Committee would admit that the tax credit for investment is unprecedented in all of our tax history and it is my opinion that we should have moved a little more cautiously, or carefully, and with a smaller percentage credit to find out the response and benefit, if any, that could or might come from such an experiment.

We proceeded today to grant a credit in substantial proportions which will most likely change this measure from a revenue-producing bill to a measure which can well create a further budget imbalance. Today the House voted a credit that American industry had not asked for and did not expect to receive. This is the only case in all tax legislation where an investor can recover his entire investment through depreciation and then obtain a tax credit over, above and beyond his original investment just as an inducement to make that investment.

The President's original proposal was that the credit be as an incentive over normal investment. For example, if a car leasing corporation would normally spend \$100 million a year to replace their old cars, the President proposes that they be given an investment credit beyond this normal replacement. But instead, our Committee on Ways and Means decided to go far beyond this and go back to the very first dollar of investment. How can the tax authorities know what is a normal investment? Well, while we are certainly not expert in the tax field, we suppose there are statistics which can be checked against every business and against every industry which reveal what has been the normal investment or reinvestment that is shown by the depreciation over a period of years. Beyond this normal investment an incentive would be realistic. But to go back to the very first dollar of investment is hardly an incentive for investment which would otherwise be made anyway, but is nothing more or less than an unprecedented and even unexpected tax reduction.

A main objection to the bill as it stood before final passage is that we had all along believed that it was designed to raise revenue and, of course, the committee believes that in the long run these incentives will accelerate business growth and increase revenue, perhaps some day, or at some unknown and uncertain time in the future, but when all is said and done we do not have a bill which is a revenue-producing bill in this calendar year or in the upcoming fiscal

year. The important thing which must be understood is that if, because of new demands for our national defense, there may have to be further expenditures, then a deficit should not be further contributed to by a so-called revenue bill which has been turned into, not a revenue bill at all, but a bill which was changed from its earlier large revenue loss to a somewhat smaller revenue loss.

If this bill were simply a bill to fill loopholes we could support it very cheerfully. Instead it has become a bill by which we turn over in tax credits, large sums of money only to those who have depreciable property and then the committee was faced with no other choice but to cast about elsewhere to find ways and places to make up this loss. It seems that this must have been about what went on within the committee: The committee members having once agreed to give an investment credit for one segment of our economy to enjoy, there was nothing else left for them to do but to find ways to offset this loss, and this they did by means of withholding interest and dividends and by such other means as increased taxation of savings institutions and mutual insurance companies, as well as the disallowance of business expense account and in other ways.

Our vote against H.R. 10650 on final passage should not imply that we are not for an improved Federal tax structure and, of course, passage of the bill by the House does not determine its final content. The bill does contain some good features, but it was not a well-balanced piece of legislation. In the final analysis, we had to determine whether the good outweighed the bad by enough to warrant support.

For the reasons cited above and for others we will omit to enumerate at this time, we could not support H.R. 10650 on final passage.

(Mr. LANE asked and was given permission to extend his remarks at this point in the RECORD.)

(Mr. LANE'S remarks will appear hereafter in the Appendix.)

WHO PAYS THE TAXES?

(Mr. McSWEEN asked and was given permission to extend his remarks at this point in the RECORD.)

Mr. McSWEEN. Mr. Speaker, last year each dollar in the Federal budget was paid in to the Treasury as follows: from individual income taxes 53 cents, from corporation income taxes 28 cents, from excise taxes 11 cents, and 8 cents from all other sources. The individual taxpayer pays more than half of the Federal budget revenues through a combination of income and excise taxes.

The average taxpayer with a modest income would probably be surprised to learn just how important to supporting the budget his tax contribution really is. Some persons are under the impression that the wealthy, whose tax rate goes as high as 91 percent, are footing most of the bill. This was the case many years ago, but last year all taxpayers earning \$15,000 and over con-

tributed only 31 percent of all Federal taxes, including social insurance.

By comparison all taxpayers earning less than \$8,000 paid 45 percent of all Federal taxes, including social insurance, or 14 percent more than the group having incomes of \$15,000 and over. So it is the hard-working, average American citizens who are shouldering a major portion of the Federal tax burden.

HOW IT'S SPENT

A typical family whose income is \$500 per month—approximately the national average—pays income taxes of \$600 per year and other Federal taxes—on gasoline, cigarettes, automobiles, tires, telephone and telegraph service, bus, train, and airline tickets, and so forth—of \$492 per year. Thus the total Federal tax bill of a typical family earning \$500 per month is \$1,092 per year, which is almost \$1 for every \$5 earned or 1½ hours in wages for each 8-hour day. Local and State taxes are in addition.

The Federal Government last year spent this \$1,092, as follows:

	Percent	Amount
Major national security.....	58	\$634
Interest on national debt.....	11	120
Veterans.....	6	65
Agriculture.....	6	65
Labor and welfare.....	6	65
Commerce, housing, and space.....	4	44
International.....	4	44
National resources.....	3	33
General government.....	2	22

This heavy tax burden is often not fully realized. The excise taxes are "hidden." Income taxes are withheld from the wage earner at the source and are thus paid on the installment plan. But taxpayers are becoming more concerned with how their tax dollar is spent. They are unhappy with heavy Federal spending and deficits.

A budget of \$92.5 billion has been recommended for next year, the largest since World War II. At the rate of current spending the budget will exceed \$100 billion by 1964, irrespective of the effect of new demands for additional spending being advocated daily by pressure groups and lobbying organizations.

The spenders are becoming stronger. Our budget deficits since World War II, including over \$7 billion this year, have added over \$35 billion to the national debt. The pressure for additional taxes is becoming greater. It is easy to see that we must either increase tax revenues or reduce our rate of increasing expenditures.

My constituents tell me in no uncertain terms that taxes are already high enough. I wholeheartedly agree. In fact, we should make every effort to reduce our rate of increasing expenditures and for an early tax cut. Mr. Speaker, I shall continue my efforts for economy in Government in the interest of the hard-working average citizen whose taxes support our Government. I urge the House to remember that the average taxpayer is carrying a heavy tax burden that should be lightened and could be lightened if Congress would only practice care in the spending of his tax dollars.

87TH CONGRESS
2D SESSION

H. R. 10650

IN THE SENATE OF THE UNITED STATES

APRIL 2, 1962

Read twice and referred to the Committee on Finance

AN ACT

To amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE, ETC.**

4 (a) **SHORT TITLE.**—This Act may be cited as the
5 “Revenue Act of 1962”.

1 (b) TABLE OF CONTENTS.—

- Sec. 1. Short title, etc.
 - (a) Short title.
 - (b) Table of contents.
 - (c) Amendment of 1954 code.
- Sec. 2. Credit for investment in certain depreciable property.
 - (a) Allowance of credit.
 - (b) Rules for computing credit.
 - (c) Certain corporate acquisitions.
 - (d) Clerical amendment.
 - (e) Effective date.
- Sec. 3. Appearances, etc., with respect to legislation.
 - (a) In general.
 - (b) Effective date.
- Sec. 4. Disallowance of certain entertainment, etc., expenses.
 - (a) Denial of deduction.
 - (b) Traveling expenses.
 - (c) Effective date.
- Sec. 5. Amount of distribution where certain foreign corporations distribute property in kind.
 - (a) Amount distributed.
 - (b) Basis.
 - (c) Dividends received from certain foreign corporations.
 - (d) Credit for foreign taxes.
 - (e) Effective date.
- Sec. 6. Amendment of section 482.
 - (a) In general.
 - (b) Clerical amendment.
 - (c) Effective date.
- Sec. 7. Distributions of foreign personal holding company income.
 - (a) Definition of foreign personal holding company.
 - (b) Amount of undistributed income.
 - (c) Effective date.
- Sec. 8. Mutual savings banks, etc.
 - (a) Reserves for losses on loans.
 - (b) Foreclosure on property securing loans.
 - (c) Definition of domestic building and loan association.
 - (d) Clerical amendments.
 - (e) Repeal of exemption from communications and transportation of persons taxes.
 - (f) Effective dates.
- Sec. 9. Distributions by foreign trusts.
 - (a) Definitions.
 - (b) Accumulation distributions of foreign trusts.

- (c) Allocation of accumulation distributions to preceding years.
- (d) Amounts treated as received in prior years.
- (e) Special rules for foreign trusts.
- (f) Information returns with respect to foreign trusts.
- (g) Failure to file information returns.
- (h) United States person defined.
- (i) Technical amendments.
- (j) Effective date.

Sec. 10. Mutual insurance companies (other than life, marine, and certain fire insurance companies), etc.

- (a) Imposition of tax.
- (b) Taxable investment income.
- (c) Statutory underwriting income or loss.
- (d) Mutual fire insurance companies operating on basis of premium deposits.
- (e) Election of certain mutual companies to be taxed on total income.
- (f) Technical amendments, etc.
- (g) Effective date.

Sec. 11. Domestic corporations receiving dividends from foreign corporations.

- (a) Entire amount of foreign tax to be taken into account.
- (b) Inclusion in gross income of amount equal to taxes deemed paid.
- (c) Determination of source of dividends received from certain foreign corporations.
- (d) Repeal of section 902(d).
- (e) Technical amendments.
- (f) Effective date.

Sec. 12. Earned income from sources without the United States.

- (a) Limitation on amount and type of income excluded.
- (b) Computation of employees' contributions.
- (c) Effective date.

Sec. 13. Controlled foreign corporations.

- (a) In general.
- (b) Technical and clerical amendments.
- (c) Effective date.

Sec. 14. Gain from dispositions of certain depreciable property.

- (a) In general.
- (b) Change in method of depreciation.
- (c) Salvage value of personal property.
- (d) Special rule for charitable contributions of section 1245 property.
- (e) Technical amendments.
- (f) Effective date.

Sec. 15. Foreign investment companies.

- (a) Treatment of sale of stock of foreign investment companies.
- (b) Conforming amendments.
- (c) Effective date.

Sec. 16. Gain from certain sales or exchanges of stock in certain foreign corporations.

- (a) Treatment of gain from the redemption, cancellation, or sale of stock in certain foreign corporations.
- (b) Clerical amendment.
- (c) Effective date.

Sec. 17. Tax treatment of cooperatives and patrons.

- (a) In general.
- (b) Technical amendments.
- (c) Effective dates.

Sec. 18. Inclusion of foreign real property in gross estate.

- (a) Amendments to include foreign real property.
- (b) Effective date.

Sec. 19. Withholding of income tax at source on interest, dividends, and patronage dividends.

- (a) In general.
- (b) Credits against income tax for tax withheld.
- (c) Interest and dividends paid to nonresident aliens, etc.
- (d) Credit for States and tax-exempt organizations.
- (e) Other technical amendments.
- (f) Effective dates.

Sec. 20. Information with respect to certain foreign entities.

- (a) Information to be furnished by individuals, domestic corporations, etc., with respect to certain foreign corporations.
- (b) Information as to organization or reorganization of foreign corporations and as to acquisitions of their stock.
- (c) Civil penalty for failure to file return.
- (d) Technical amendments.
- (e) Effective date.

Sec. 21. Treaties.

1 (c) AMENDMENT OF 1954 CODE.—Whenever in this
2 Act an amendment or repeal is expressed in terms of an
3 amendment to, or repeal of, a section or other provision,
4 the reference shall be considered to be made to a section or
5 other provision of the Internal Revenue Code of 1954.

6 **SEC. 2. CREDIT FOR INVESTMENT IN CERTAIN DEPRE**
7 **CIABLE PROPERTY.**

8 (a) ALLOWANCE OF CREDIT.—Part IV of subchapter
9 A of chapter 1 (relating to credits against tax) is amended
10 by redesignating section 38 as section 40 and by inserting
11 after section 37 the following new section:

12 **“SEC. 38. INVESTMENT IN CERTAIN DEPRECIABLE PROP-**
13 **ERTY.**

14 “(a) GENERAL RULE.—There shall be allowed, as a
15 credit against the tax imposed by this chapter, the amount
16 determined under subpart B of this part.

17 “(b) REGULATIONS.—The Secretary or his delegate
18 shall prescribe such regulations as may be necessary to carry
19 out the purposes of this section and subpart B.”

20 (b) RULES FOR COMPUTING CREDIT.—Part IV of sub-

1 chapter A of chapter 1 is amended by adding at the end
2 thereof the following new subpart:

3 **“Subpart B—Rules for Computing Credit for Investment**
4 **in Certain Depreciable Property**

“Sec. 46. Amount of credit.

“Sec. 47. Certain dispositions, etc., of section 38 property.

“Sec. 48. Definitions; special rules.

5 **“SEC. 46. AMOUNT OF CREDIT.**

6 **“(a) DETERMINATION OF AMOUNT.—**

7 **“(1) GENERAL RULE.—**The amount of the credit
8 allowed by section 38 for the taxable year shall be equal
9 to 7 percent of the qualified investment (as defined in
10 subsection (c)).

11 **“(2) LIMITATION BASED ON AMOUNT OF TAX.—**
12 Notwithstanding paragraph (1), the credit allowed by
13 section 38 for the taxable year shall not exceed—

14 **“(A)** so much of the liability for tax for the
15 taxable year as does not exceed \$25,000, plus

16 **“(B)** 25 percent of so much of the liability
17 for tax for the taxable year as exceeds \$25,000.

18 **“(3) LIABILITY FOR TAX.—**For purposes of para-
19 graph (2), the liability for tax for the taxable year shall
20 be the tax imposed by this chapter for such year,
21 reduced by the sum of the credits allowable under—

22 **“(A)** section 33 (relating to foreign tax
23 credit),

1 “(B) section 34 (relating to dividends re-
2 ceived by individuals),

3 “(C) section 35 (relating to partially tax-
4 exempt interest), and

5 “(D) section 37 (relating to retirement in-
6 come).

7 For purposes of this paragraph, any tax imposed for the
8 taxable year by section 531 (relating to accumulated
9 earnings tax) or by section 541 (relating to personal
10 holding company tax) shall not be considered tax
11 imposed by this chapter for such year.

12 “(4) MARRIED INDIVIDUALS.—In the case of a
13 husband or wife who files a separate return, the amount
14 specified under subparagraphs (A) and (B) of para-
15 graph (2) shall be \$12,500 in lieu of \$25,000. This
16 paragraph shall not apply if the spouse of the taxpayer
17 has no qualified investment for, and no unused credit
18 carryover to, the taxable year of such spouse which ends
19 within or with the taxpayer’s taxable year.

20 “(5) AFFILIATED GROUPS.—In the case of an
21 affiliated group, the \$25,000 amount specified under
22 subparagraphs (A) and (B) of paragraph (2) shall be
23 reduced for each member of the group by apportioning
24 \$25,000 among the members of such group in such
25 manner as the Secretary or his delegate shall by regula-

1 tions prescribe. For purposes of the preceding sentence,
2 the term 'affiliated group' has the meaning assigned to
3 such term by section 1504 (a), except that all corpora-
4 tions shall be treated as includible corporations (with-
5 out any exclusion under section 1504 (b)).

6 “(b) 5-YEAR CARRYOVER OF UNUSED CREDITS.—

7 “(1) ALLOWANCE OF CREDIT.—If the amount of
8 the credit determined under subsection (a) (1) for any
9 taxable year exceeds the limitation provided by subsec-
10 tion (a) (2) for such taxable year (hereinafter in this
11 subsection referred to as 'unused credit year'), such
12 excess shall be added to the amount allowable as a credit
13 by section 38 for each of the 5 succeeding taxable years
14 to the extent not taken into account for taxable years
15 intervening between the unused credit year and such
16 succeeding taxable year.

17 “(2) LIMITATION.—The amount of the unused
18 credit which may be added under paragraph (1) for any
19 succeeding taxable year shall not exceed the amount by
20 which the limitation provided by subsection (a) (2) for
21 such taxable year exceeds the sum of—

22 “(A) the credit allowable under subsection
23 (a) (1) for such taxable year, and

24 “(B) the amounts which, by reason of this
25 subsection, are added to the amount allowable for

such taxable year and attributable to taxable years
preceding the unused credit year.

“(c) QUALIFIED INVESTMENT.—

“(1) IN GENERAL.—For purposes of this subpart,
the term ‘qualified investment’ means, with respect to
any taxable year, the aggregate of—

“(A) the applicable percentage of the basis of
each new section 38 property (as defined in section
48 (b)) placed in service by the taxpayer during
such taxable year, plus

“(B) the applicable percentage of the cost of
each used section 38 property (as defined in section
48 (c) (1)) placed in service by the taxpayer dur-
ing such taxable year.

“(2) APPLICABLE PERCENTAGE.—For purposes of
paragraph (1), the applicable percentage for any prop-
erty shall be determined under the following table:

“If the useful life is—	The applicable percentage is—
4 years or more but less than 6 years.....	33½
6 years or more but less than 8 years.....	66⅔
8 years or more.....	100

For purposes of this paragraph, the useful life of any
property shall be determined as of the time such property
is placed in service by the taxpayer.

1 “(3) PUBLIC UTILITY PROPERTY.—

2 “(A) In the case of section 38 property which
3 is public utility property, the amount of the qualified
4 investment shall be $\frac{3}{7}$ of the amount determined
5 under paragraph (1).

6 “(B) For purposes of subparagraph (A), the
7 term ‘public utility property’ means property used
8 predominantly in the trade or business of the fur-
9 nishing or sale of—

10 “(i) electrical energy, water, or sewage
11 disposal services,

12 “(ii) gas through a local distribution sys-
13 tem,

14 “(iii) telephone service, or

15 “(iv) telegraph service by means of do-
16 mestic telegraph operations (as defined in
17 section 222 (a) (5) of the Communications Act
18 of 1934, as amended; 47 U.S.C., sec. 222 (a)
19 (5)),

20 if the rates for such furnishing or sale, as the case
21 may be, have been established or approved by a
22 State or political subdivision thereof, by an agency
23 or instrumentality of the United States, or by a
24 public service or public utility commission or other

14 similar body of any State or political subdivision
15 thereof.

16 “(d) LIMITATIONS WITH RESPECT TO CERTAIN PER-
17 SONS.—

18 “(1) IN GENERAL.—In the case of—

19 “(A) an organization to which section 593
20 applies,

21 “(B) a regulated investment company or a
22 real estate investment trust subject to taxation un-
23 der subchapter M (sec. 851 and following), and

24 “(C) a cooperative organization described in
1 section 1381 (a),

2 the qualified investment and the \$25,000 amount
3 specified under subparagraphs (A) and (B) of sub-
4 section (a) (2) shall equal such person's ratable share
5 of such items.

6 “(2) RATABLE SHARE.—For purposes of para-
7 graph (1), the ratable share of any person for any
8 taxable year of the items described therein shall be—

9 “(A) in the case of an organization referred
10 to in paragraph (1) (A), 50 percent thereof,

11 “(B) in the case of a regulated investment
12 company or a real estate investment trust, the ratio
13 (i) the numerator of which is its taxable income and

1 (ii) the denominator of which is its taxable income
2 computed without regard to the deduction for divi-
3 dends paid provided by section 852 (b) (2) (D) or
4 857 (b) (2) (C), as the case may be, and

5 “(C) in the case of a cooperative organization,
6 the ratio (i) the numerator of which is its taxable
7 income and (ii) the denominator of which is its
8 taxable income increased by amounts to which
9 section 1382 (b) or (c) applies and similar amounts
10 the tax treatment of which is determined without
11 regard to subchapter T (sec. 1381 and following).

12 For purposes of subparagraph (B) of the preceding
13 sentence, the term ‘taxable income’ means in the case of
14 a regulated investment company its investment company
15 taxable income (within the meaning of section
16 852 (b) (2)), and in the case of a real estate invest-
17 ment trust its real estate investment trust taxable in-
18 come (within the meaning of section 857 (b) (2)).

19 **“SEC. 47. CERTAIN DISPOSITIONS, ETC., OF SECTION 38**
20 **PROPERTY.**

21 “(a) **GENERAL RULE.**—Under regulations prescribed
22 by the Secretary or his delegate—

23 “(1) **EARLY DISPOSITION, ETC.**—If during any tax-
24 able year any property is disposed of, or otherwise

1 ceases to be section 38 property with respect to the tax-
2 payer, before the close of the useful life which was taken
3 into account in computing the credit under section 38,
4 then the tax under this chapter for such taxable year
5 shall be increased by an amount equal to the aggregate
6 decrease in the credits allowed under section 38 for all
7 prior taxable years which would have resulted solely
8 from substituting, in determining qualified investment,
9 for such useful life the period beginning with the time
10 such property was placed in service by the taxpayer and
11 ending with the time such property ceased to be section
12 38 property.

13 “(2) PROPERTY BECOMES PUBLIC UTILITY PROP-
14 erty.—If during any taxable year any property taken
15 into account in determining qualified investment becomes
16 public utility property (within the meaning of section
17 46 (c) (3) (B)), then the tax under this chapter for
18 such taxable year shall be increased by an amount equal
19 to the aggregate decrease in the credits allowed under
20 section 38 for all prior taxable years which would have
21 resulted solely from treating the property, for purposes
22 of determining qualified investment, as public utility
23 property (after giving due regard to the period before
24 such change in use). If the application of this paragraph

1 to any property is followed by the application of para-
2 graph (1) to such property, proper adjustment shall be
3 made in applying paragraph (1).

4 “(3) CARRYOVERS ADJUSTED.—In the case of
5 any cessation described in paragraph (1) or any
6 change in use described in paragraph (2), the carry-
7 overs under section 46 (b) shall be adjusted by reason
8 of such cessation (or change in use).

9 “(b) SECTION NOT TO APPLY IN CERTAIN CASES.—
10 Subsection (a) shall not apply to—

11 “(1) a transfer by reason of death, or

12 “(2) a transaction to which section 381 (a) applies.

13 For purposes of subsection (a), property shall not be treated
14 as ceasing to be section 38 property with respect to the tax-
15 payer by reason of a mere change in the form of conducting
16 the trade or business so long as the property is retained in
17 such trade or business as section 38 property and the tax-
18 payer retains a substantial interest in such trade or business.

19 “(c) SPECIAL RULE.—Any increase in tax under sub-
20 section (a) shall not be treated as tax imposed by this
21 chapter for purposes of determining the amount of any credit
22 allowable under subpart A.

1 "SEC. 48. DEFINITIONS; SPECIAL RULES.

2 "(a) SECTION 38 PROPERTY.—

3 "(1) IN GENERAL.—Except as provided in this
4 subsection, the term 'section 38 property' means—

5 "(A) tangible personal property, or

6 "(B) other tangible property (not including
7 a building and its structural components) but only
8 if such property—

9 "(i) is used as an integral part of manu-
10 facturing, production, or extraction or of fur-
11 nishing transportation, communications, elec-
12 trical energy, gas, water, or sewage disposal
13 services, or

14 "(ii) constitutes a research or storage fa-
15 cility used in connection with any of the activi-
16 ties referred to in clause (i).

17 Such term includes only property with respect to which
18 depreciation (or amortization in lieu of depreciation) is
19 allowable and having a useful life (determined as of
20 the time such property is placed in service) of 4 years
21 or more.

1 “(2) PROPERTY USED OUTSIDE THE UNITED
2 STATES.—

3 “(A) IN GENERAL.—Except as provided in
4 subparagraph (B), the term ‘section 38 property’
5 does not include property which is used predomi-
6 nantly outside the United States.

7 “(B) EXCEPTIONS.—Subparagraph (A) shall
8 not apply to—

9 “(i) any aircraft which is registered by
10 the Administrator of the Federal Aviation
11 Agency and which is operated to and from the
12 United States;

13 “(ii) rolling stock, of a domestic railroad
14 corporation subject to part I of the Interstate
15 Commerce Act, which is used within and with-
16 out the United States;

17 “(iii) any vessel documented under the
18 laws of the United States which is operated in
19 the foreign or domestic commerce of the United
20 States;

21 “(iv) any motor vehicle of a United States
22 person (as defined in section 7701 (a) (30))
23 which is operated to and from the United
24 States;

25 “(v) any container of a United States

person which is used in the transportation of property to and from the United States; and

“(vi) any property (other than a vessel or an aircraft) of a United States person which is used for the purpose of exploring for, developing, removing, or transporting resources from the outer Continental Shelf (within the meaning of section 2 of the Outer Continental Shelf Lands Act, as amended and supplemented; 43 U.S.C., sec. 1331).

“(3) PROPERTY USED FOR LODGING.—Property which is used predominantly to furnish lodging or in connection with the furnishing of lodging shall not be treated as section 38 property. The preceding sentence shall not apply to—

“(A) nonlodging commercial facilities which are available to persons not using the lodging facilities on the same basis as they are available to persons using the lodging facilities, and

“(B) property used by a hotel or motel in connection with the trade or business of furnishing lodging where the predominant portion of the accommodations is used by transients.

“(4) PROPERTY USED BY CERTAIN TAX-EXEMPT

1 ORGANIZATIONS.—Property used by an organization
2 (other than a cooperative described in section 521)
3 which is exempt from the tax imposed by this chapter
4 shall be treated as section 38 property only if such
5 property is used predominantly in an unrelated trade or
6 business the income of which is subject to tax under
7 section 511.

8 “(5) PROPERTY USED BY GOVERNMENTAL
9 UNITS.—Property used by the United States, any State
10 or political subdivision thereof, any international organ-
11 ization, or any agency or instrumentality of any of the
12 foregoing shall not be treated as section 38 property.

13 “(b) NEW SECTION 38 PROPERTY.—For purposes of
14 this subpart, the term ‘new section 38 property’ means sec-
15 tion 38 property—

16 “(1) the construction, reconstruction, or erection
17 of which is completed by the taxpayer after December
18 31, 1961, or

19 “(2) acquired after December 31, 1961, if the
20 original use of such property commences with the tax-
21 payer and commences after such date.

22 In applying section 46(c) (1) (A) in the case of property
23 described in paragraph (1), there shall be taken into account

1 only that portion of the basis which is properly attributable
2 to construction, reconstruction, or erection after December
3 31, 1961.

4 “(c) USED SECTION 38 PROPERTY.—

5 “(1) IN GENERAL.—For purposes of this subpart,
6 the term ‘used section 38 property’ means section 38
7 property acquired by purchase after December 31, 1961,
8 which is not new section 38 property. Property shall
9 not be treated as ‘used section 38 property’ if, after its
10 acquisition by the taxpayer, it is used by a person who
11 used such property before such acquisition (or by a
12 person who bears a relationship described in section
13 179(d)(2)(A) or (B) to a person who used such
14 property before such acquisition).

15 “(2) DOLLAR LIMITATION.—

16 “(A) IN GENERAL.—The cost of used section
17 38 property taken into account under section 46
18 (c)(1)(B) for any taxable year shall not exceed
19 \$50,000. If such cost exceeds \$50,000, the tax-
20 payer shall select (at such time and in such manner
21 as the Secretary or his delegate shall by regulations
22 prescribe) the items to be taken into account, but
23 only to the extent of an aggregate cost of \$50,000.

1 Such a selection, once made, may be changed only
2 in the manner, and to the extent, provided by such
3 regulations.

4 “(B) MARRIED INDIVIDUALS.—In the case of
5 a husband or wife who files a separate return, the
6 limitation under subparagraph (A) shall be
7 \$25,000 in lieu of \$50,000. This subparagraph
8 shall not apply if the spouse of the taxpayer has no
9 used section 38 property which may be taken into
10 account as qualified investment for the taxable year
11 of such spouse which ends within or with the tax-
12 payer’s taxable year.

13 “(C) AFFILIATED GROUPS.—In the case of an
14 affiliated group, the \$50,000 amount specified under
15 subparagraph (A) shall be reduced for each mem-
16 ber of the group by apportioning \$50,000 among
17 the members of such group in accordance with their
18 respective amounts of used section 38 property
19 which may be taken into account.

20 “(D) PARTNERSHIPS.—In the case of a part-
21 nership, the limitation contained in subparagraph
22 (A) shall apply with respect to the partnership and
23 with respect to each partner.

24 “(3) DEFINITIONS.—For purposes of this sub-
25 section—

1 “(A) PURCHASE.—The term ‘purchase’ has
2 the meaning assigned to such term by section
3 179 (d) (2) .

4 “(B) COST.—The cost of used section 38
5 property does not include so much of the basis of
6 such property as is determined by reference to the
7 adjusted basis of other property held at any time by
8 the person acquiring such property. If property is
9 disposed of and used section 38 property similar or
10 related in service or use is acquired as a replace-
11 ment therefor in a transaction to which the pre-
12 ceding sentence does not apply, the cost of the used
13 section 38 property acquired shall be its basis re-
14 duced by the adjusted basis of the property re-
15 placed. The cost of used section 38 property shall
16 not be reduced with respect to the adjusted basis of
17 any property disposed of if, by reason of section 47,
18 such disposition involved an increase of tax or
19 a reduction of the unused credit carryovers described
20 in section 46 (b) .

21 “(C) AFFILIATED GROUP.—The term ‘affili-
22 ated group’ has the meaning assigned to such term
23 by section 1504 (a) , except that—

24 “(i) the phrase ‘more than 50 percent’
25 shall be substituted for the phrase ‘at least 80

1 percent' each place it appears in section
2 1504 (a), and

3 “(ii) all corporations shall be treated as
4 includible corporations (without any exclusion
5 under section 1504 (b)).

6 “(d) CERTAIN LEASED PROPERTY.—A person (other
7 than a person referred to in section 46 (d)) engaged in the
8 business of leasing property may (at such time, in such
9 manner, and subject to such conditions as are provided by
10 regulations prescribed by the Secretary or his delegate)
11 elect with respect to any new section 38 property to treat
12 the lessee as having acquired such property for an amount
13 equal to—

14 “(1) if such property was constructed by the lessor
15 (or by a corporation which controls or is controlled by
16 the lessor within the meaning of section 368 (c)), the
17 fair market value of such property, or

18 “(2) if paragraph (1) does not apply, the basis
19 of such property to the lessor.

20 The election provided by the preceding sentence may be
21 made only with respect to property which would be new
22 section 38 property if acquired by the lessee. For purposes
23 of the preceding sentence and section 46 (c) , the useful life
24 of property in the hands of the lessee is the useful life of such
25 property in the hands of the lessor. If a lessor makes the

1 election provided by this subsection with respect to any
2 property, the lessee shall be treated for all purposes of this
3 subpart as having acquired such property.

4 “(e) SUBCHAPTER S CORPORATIONS.—In the case of
5 an electing small business corporation (as defined in section
6 1371)—

7 “(1) the qualified investment for each taxable year
8 shall be apportioned pro rata among the persons who
9 are shareholders of such corporation on the last day of
10 such taxable year; and

11 “(2) any person to whom any investment has been
12 apportioned under paragraph (1) shall be treated (for
13 purposes of this subpart) as the taxpayer with respect
14 to such investment, and such investment shall not (by
15 reason of such apportionment) lose its character as an
16 investment in new section 38 property or used section
17 38 property, as the case may be.

18 “(f) ESTATES AND TRUSTS.—In the case of an estate
19 or trust—

20 “(1) the qualified investment for any taxable year
21 shall be apportioned between the estate or trust and the
22 beneficiaries on the basis of the income of the estate or
23 trust allocable to each,

24 “(2) any beneficiary to whom any investment has
25 been apportioned under paragraph (1) shall be treated

1 (for purposes of this subpart) as the taxpayer with re-
 2 spect to such investment, and such investment shall not
 3 (by reason of such apportionment) lose its character as
 4 an investment in new section 38 property or used section
 5 38 property, as the case may be, and

6 “(3) the \$25,000 amount specified under sub-
 7 paragraphs (A) and (B) of section 46(a)(2) ap-
 8 plicable to such estate or trust shall be reduced to an
 9 amount which bears the same ratio to \$25,000 as the
 10 amount of the qualified investment allocated to the
 11 estate or trust under paragraph (1) bears to the entire
 12 amount of the qualified investment.

13 “(g) CROSS REFERENCE.—

“For application of this subpart to certain acquiring corporations, see section 381(c)(23).”

14 (c) CERTAIN CORPORATE ACQUISITIONS.—Section
 15 381(c) (relating to items taken into account in certain
 16 corporate acquisitions) is amended by adding at the end
 17 thereof the following new paragraph:

18 “(23) CREDIT UNDER SECTION 38 FOR INVEST-
 19 MENT IN CERTAIN DEPRECIABLE PROPERTY.—The ac-
 20 quiring corporation shall take into account (to the ex-
 21 tent proper to carry out the purposes of this section and
 22 section 38, and under such regulations as may be pre-
 23 scribed by the Secretary or his delegate) the items re-

quired to be taken into account for purposes of section 38 in respect of the distributor or transferor corporation.”

(d) CLERICAL AMENDMENT.—Part IV of subchapter A of chapter 1 is amended by inserting after the heading and before the table of sections the following:

“Subpart A. Credits allowable.

“Subpart B. Rules for computing credit for investment in certain depreciable property.

“Subpart A—Credits Allowable”

(e) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years ending after December 31, 1961.

SEC. 3. APPEARANCES, ETC., WITH RESPECT TO LEGISLATION.

(a) IN GENERAL.—Section 162 (relating to trade or business expenses) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

“(e) APPEARANCES, ETC., WITH RESPECT TO LEGISLATION.—

“(1) IN GENERAL.—The deduction allowed by subsection (a) shall include all the ordinary and necessary expenses (including, but not limited to, traveling expenses described in subsection (a) (2) and the cost

1 of preparing testimony) paid or incurred during the tax-
2 able year in carrying on any trade or business—

3 “(A) in direct connection with appearances
4 before, submission of statements to, or sending com-
5 munications to, the committees, or individual mem-
6 bers, of Congress or of any legislative body of a
7 State, a possession of the United States, or a politi-
8 cal subdivision of any of the foregoing with respect
9 to legislation or proposed legislation of direct inter-
10 est to the taxpayer, or

11 “(B) in direct connection with communication
12 of information between the taxpayer and an organ-
13 ization of which he is a member with respect to
14 legislation or proposed legislation of direct interest
15 to the taxpayer and to such organization,

16 and that portion of the dues so paid or incurred with
17 respect to any organization of which the taxpayer is a
18 member which is attributable to the expenses of the
19 activities described in subparagraphs (A) and (B)
20 carried on by such organization.

21 “(2) LIMITATION.—The provisions of paragraph
22 (1) shall not be construed as allowing the deduction of
23 any amount paid or incurred (whether by way of con-
24 tribution, gift, or otherwise) —

25 “(A) for participation in, or intervention in,

any political campaign on behalf of any candidate
for public office, or

“(B) in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums.”

(b) **EFFECTIVE DATE.**—The amendments made by this section shall apply to taxable years beginning after December 31, 1962.

SEC. 4. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES.

(a) **DENIAL OF DEDUCTION.**—

(1) Part IX of subchapter B of chapter 1 (relating to items not deductible in computing taxable income) is amended by adding at the end thereof the following new section:

“SEC. 274. DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC., EXPENSES.

“(a) ENTERTAINMENT, AMUSEMENT, OR RECREATION.—

“(1) IN GENERAL.—No deduction otherwise allowable under this chapter shall be allowed for any item—

“(A) ACTIVITY.—With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless

1 the taxpayer establishes that the item was directly
2 related to the active conduct of the taxpayer's trade
3 or business, or

4 “(B) FACILITY.—With respect to a facility
5 used in connection with an activity referred to in
6 subparagraph (A), unless the taxpayer establishes
7 that the facility was used primarily for the further-
8 ance of the taxpayer's trade or business and that the
9 item was directly related to the active conduct of
10 such trade or business,
11 and such deduction shall in no event exceed the portion
12 of such item directly related to the active conduct of the
13 taxpayer's trade or business.

14 “(2) SPECIAL RULES.—For purposes of applying
15 paragraph (1) —

16 “(A) Dues or fees to any social, athletic, or
17 sporting club or organization shall be treated as
18 items with respect to facilities.

19 “(B) An activity described in section 212
20 shall be treated as a trade or business.

21 “(b) GIFTS.—

22 “(1) LIMITATION.—No deduction shall be allowed
23 under section 162 or section 212 for any expense for
24 gifts made directly or indirectly to any individual to the
25 extent that such expense, when added to prior expenses

1 of the taxpayer for gifts made to such individual during
2 the same taxable year, exceeds \$25. For purposes of
3 this section, the term 'gift' means any item excludable
4 from gross income of the recipient under section 102
5 which is not excludable from his gross income under any
6 other provision of this chapter.

7 “(2) SPECIAL RULES.—

8 “(A) In the case of a gift by a partnership, the
9 limitation contained in paragraph (1) shall apply
10 to the partnership as well as to each member thereof.

11 “(B) For purposes of paragraph (1), a hus-
12 band and wife shall be treated as one taxpayer.

13 “(c) SUBSTANTIATION REQUIRED.—No deduction shall
14 be allowed—

15 “(1) under section 162 or 212 for any traveling
16 expense (including meals and lodging while away from
17 home),

18 “(2) for any item with respect to an activity which
19 is of a type generally considered to constitute entertain-
20 ment, amusement, or recreation, or with respect to a
21 facility used in connection with such an activity, or

22 “(3) for any expense for gifts,
23 unless the taxpayer substantiates by adequate records or by
24 sufficient evidence corroborating his own statement (A) the
25 amount of such expense or other item, (B) the time and

1 place of the travel, entertainment, amusement, recreation, or
2 use of the facility, or the date and description of the gift, (C)
3 the business purpose of the expense or other item, and (D)
4 the business relationship to the taxpayer of persons enter-
5 tained, using the facility, or receiving the gift. The Secre-
6 tary or his delegate may by regulations provide that some
7 or all of the requirements of the preceding sentence shall not
8 apply in the case of an expense which does not exceed an
9 amount prescribed pursuant to such regulations.

10 “(d) SPECIFIC EXCEPTIONS TO APPLICATION OF SUB-
11 SECTION (a).—Subsection (a) shall not apply to—

12 “(1) BUSINESS MEALS.—Expenses for food and
13 beverages furnished to any individual under circum-
14 stances which (taking into account the surroundings in
15 which furnished, the taxpayer’s trade, business, or in-
16 come-producing activity and the relationship to such
17 trade, business, or activity of the persons to whom the
18 food and beverages are furnished) are of a type generally
19 considered to be conducive to a business discussion.

20 “(2) FOOD AND BEVERAGES FOR EMPLOYEES.—
21 Expenses for food and beverages (and facilities used
22 in connection therewith) furnished on the business prem-
23 ises of the taxpayer primarily for his employees.

24 “(3) EXPENSES TREATED AS COMPENSATION.—
25 Expenses for goods, services, and facilities, to the ex-

1 tent that the expenses are treated by the taxpayer, with
2 respect to the recipient of the entertainment, amusement,
3 or recreation, as compensation to an employee on the
4 taxpayer's return of tax under this chapter and as wages
5 to such employee for purposes of chapter 24 (relating
6 to withholding of income tax at source on wages) .

7 “(4) REIMBURSED EXPENSES.—Expenses paid or
8 incurred by the taxpayer, in connection with the per-
9 formance by him of services for another person
10 (whether or not such other person is his employer),
11 under a reimbursement or other expense allowance
12 arrangement with such other person, but this para-
13 graph shall apply—

14 “(A) where the services are performed for
15 an employer, only if the employer has not treated
16 such expenses in the manner provided in paragraph
17 (3), or

18 “(B) where the services are performed for a
19 person other than an employer, only if the tax-
20 payer accounts (to the extent provided by sub-
21 section (c)) to such person.

22 “(5) RECREATIONAL, ETC., EXPENSES FOR EM-
23 PLOYEES.—Expenses for recreational, social, or similar
24 activities (including facilities therefor) primarily for
25 the benefit of employees (other than employees who

1 are officers, shareholders or other owners, or highly
2 compensated employees). For purposes of this para-
3 graph, an individual owning less than a 10-percent in-
4 terest in the taxpayer's trade or business shall not be
5 considered a shareholder or other owner, and for such
6 purposes an individual shall be treated as owning any
7 interest owned by a member of his family (within the
8 meaning of section 267 (c) (4)).

9 “(6) EMPLOYEE AND STOCKHOLDER BUSINESS
10 MEETINGS.—Expenses directly related to business meet-
11 ings of employees or stockholders.

12 “(7) MEETINGS OF BUSINESS LEAGUES, ETC.—
13 Expenses directly related and necessary to attendance at
14 a business meeting or convention of any organization
15 described in section 501 (c) (6) (relating to business
16 leagues, chambers of commerce, real estate boards, and
17 boards of trade) and exempt from taxation under section
18 501 (a) .

19 “(8) ITEMS AVAILABLE TO PUBLIC.—Expenses for
20 goods, services, and facilities made available by the tax-
21 payer to the general public.

22 “(9) ENTERTAINMENT SOLD TO CUSTOMERS.—Ex-
23 penses for goods or services (including the use of facili-
24 ties) which are sold by the taxpayer in a bona fide

1 transaction for an adequate and full consideration in
2 money or money's worth.

3 For purposes of this subsection, any item referred to in sub-
4 section (a) shall be treated as an expense.

5 “(e) INTEREST, TAXES, CASUALTY LOSSES, ETC.—
6 This section shall not apply to any deduction allowable to
7 the taxpayer without regard to its connection with his trade
8 or business (or with his income-producing activity). In the
9 case of a taxpayer which is not an individual, the preceding
10 sentence shall be applied as if it were an individual.

11 “(f) TREATMENT OF ENTERTAINMENT, ETC., TYPE
12 FACILITY.—For purposes of this chapter, if deductions are
13 disallowed under subsection (a) with respect to any portion
14 of a facility, such portion shall be treated as an asset which is
15 used for personal, living, and family purposes (and not as
16 an asset used in the trade or business).

17 “(g) REGULATORY AUTHORITY.—The Secretary or his
18 delegate shall prescribe such regulations as he may deem
19 necessary to carry out the purposes of this section, includ-
20 ing regulations prescribing whether subsection (a) or sub-
21 section (b) applies in cases where both such subsections
22 would otherwise apply.”

1 (2) The table of sections for such part IX is amended
2 by adding at the end thereof the following:

“Sec. 274. Disallowance of certain entertainment, etc., ex-
penses.”

3 (b) TRAVELING EXPENSES.—Section 162 (a) (2) (re-
4 lating to traveling expenses) is amended by striking out
5 “(including the entire amount expended for meals and lodg-
6 ing)” and inserting in lieu thereof “(including a reasonable
7 allowance for amounts expended for meals and lodging)”.

8 (c) EFFECTIVE DATE.—The amendments made by this
9 section shall apply with respect to taxable years ending after
10 June 30, 1962, but only in respect of periods after such
11 date.

12 **SEC. 5. AMOUNT OF DISTRIBUTION WHERE CERTAIN**
13 **FOREIGN CORPORATIONS DISTRIBUTE PROP-**
14 **ERTY IN KIND.**

15 (a) AMOUNT DISTRIBUTED.—Section 301 (b) (1)
16 (relating to amount distributed to corporate distributees) is
17 amended by adding at the end thereof the following new
18 subparagraph:

19 “(C) CERTAIN CORPORATE DISTRIBUTEES OF
20 FOREIGN CORPORATION.—Notwithstanding subpara-
21 graph (B), if the shareholder is a corporation and
22 the distributing corporation is a foreign corporation,
23 the amount taken into account with respect to

property (other than money) shall be the fair market value of such property; except that if any deduction is allowable under section 245 with respect to such distribution, then the amount taken into account shall be the sum (determined under regulations prescribed by the Secretary or his delegate) of—

“(i) the proportion of the adjusted basis of such property (or, if lower, its fair market value) properly attributable to gross income from sources within the United States, and

“(ii) the proportion of the fair market value of such property properly attributable to gross income from sources without the United States.”

(b) BASIS.—Section 301 (d) (relating to basis of property) is amended by adding at the end thereof the following new paragraph:

“(3) CERTAIN CORPORATE DISTRIBUTEES OF FOREIGN CORPORATION.—In the case of property described in subparagraph (C) of subsection (b) (1), the basis shall be determined by substituting the amount determined under such subparagraph (C) for the amount described in paragraph (2) of this subsection.”

1 (c) DIVIDENDS RECEIVED FROM CERTAIN FOREIGN
2 CORPORATIONS.—

3 (1) Section 245 (relating to dividends received
4 from certain foreign corporations) is amended by add-
5 ing at the end thereof the following new subsection:

6 “(b) PROPERTY DISTRIBUTIONS.—For purposes of sub-
7 section (a), the amount of any distribution of property other
8 than money shall be the amount determined by applying
9 section 301 (b) (1) (B).”

10 (2) Section 245 is amended by striking out “In
11 the case of” and inserting in lieu thereof “(a) GENERAL
12 RULE.—In the case of”.

13 (d) CREDIT FOR FOREIGN TAXES.—Section 902 (a)
14 (relating to credit for foreign taxes) is amended by adding
15 at the end thereof the following new sentence: “For pur-
16 poses of this subsection and subsection (b), the amount of
17 any distribution in property other than money shall be the
18 amount determined by applying section 301 (b) (1) (B).”

19 (e) EFFECTIVE DATE.—The amendments made by this
20 section shall apply to distributions made after December 31,
21 1962.

22 SEC. 6. AMENDMENT OF SECTION 482.

23 (a) IN GENERAL.—Section 482 (relating to allocation
24 of income and deductions among taxpayers) is amended
25 by adding at the end thereof the following new subsection:

1 “(b) SALES AND PURCHASES WITHIN A RELATED
2 GROUP WHICH INCLUDES A FOREIGN ORGANIZATION.—

3 “(1) IN GENERAL.—In applying subsection (a)
4 to sales of tangible property within a group of organiza-
5 tions—

6 “(A) owned or controlled directly or indi-
7 rectly by the same interests, and

8 “(B) at least one of which is a domestic or-
9 ganization and at least one of which is a foreign
10 organization,

11 the Secretary or his delegate may allocate the taxable
12 income of the group arising from such sales in the
13 manner set forth in paragraph (2). This subsection
14 shall not apply with respect to any sale of tangible
15 property for which the taxpayer can establish an arm's
16 length price (within the meaning of paragraph (4)).

17 “(2) METHODS OF ALLOCATION.—

18 “(A) CONSIDERATION OF CERTAIN FAC-
19 TORS.—Except as provided in subparagraph (B),
20 the allocation referred to in paragraph (1) shall be
21 made by the Secretary or his delegate by taking into
22 consideration that portion of the following factors
23 which is attributable to the United States and that
24 portion thereof which is not attributable to the
25 United States—

1 “(i) assets of the group, to the extent used
2 in the production, distribution, and sale of the
3 property,

4 “(ii) compensation of officers and em-
5 ployees, to the extent attributable to the pro-
6 duction, distribution, and sale of the property,
7 and

8 “(iii) advertising, selling, and sales promo-
9 tion expenses (including technical and servic-
10 ing expenses), to the extent attributable to
11 the property.

12 Such method of allocation may also give considera-
13 tion to other factors, including the special risks (if
14 any) of the market in which the property is sold.

15 “(B) ALTERNATIVE METHODS.—If the tax-
16 payer establishes to the satisfaction of the Secretary
17 or his delegate that an alternative method of alloca-
18 tion clearly reflects the income of each member of
19 the group with respect to the property referred to in
20 paragraph (1), such alternative method shall be
21 used (in lieu of the method provided in subpara-
22 graph (A)).

23 “(3) SPECIAL RULES.—In applying the method
24 of allocation referred to in paragraph (2) (A), the
25 following rules shall be applied:

1 “(A) ADJUSTED BASIS OF ASSETS.—The
2 values to be assigned to the assets referred to in
3 paragraph (2) (A) (i) is their adjusted basis in the
4 hands of the taxpayer or, if such basis is not avail-
5 able in the case of a foreign organization, then their
6 book values, adjusted to approximate their adjusted
7 basis.

8 “(B) INCLUDIBLE ASSETS.—The assets re-
9 ferred to in paragraph (2) (A) (i) include real
10 property and tangible personal property (whether
11 owned or leased by a member of the group), but do
12 not include inventory and stock in trade.

13 “(4) ARM’S LENGTH PRICE DEFINED.—For pur-
14 poses of this subsection, the term ‘arm’s length price’
15 means—

16 “(A) the price at which tangible property sim-
17 ilar or comparable to the property referred to in
18 paragraph (1) generally is or can be sold in trans-
19 actions in the same areas involving unrelated per-
20 sons and made under similar conditions of sale; and

21 “(B) if subparagraph (A) does not apply, the
22 price at which tangible property similar or com-
23 parable to the property referred to in paragraph
24 (1) is sold in the same or other areas under similar
25 circumstances and in transactions involving unre

1 lated persons, with adjustment for material differ-
2 ences in quantity, marketing conditions (including
3 customs duties and transportation costs), and other
4 relevant factors.

5 Subparagraph (B) shall apply only if the adjustment
6 referred to therein is properly determinable.

7 “(5) SALES COMMISSIONS.—The Secretary or his
8 delegate shall by regulation prescribe rules for the allo-
9 cation of commissions arising from sales of tangible
10 property within a group of organizations described in
11 paragraph (1). Such rules shall be consistent with the
12 principles specified in the other paragraphs of this
13 subsection.

14 “(6) GROSSLY INADEQUATE ASSETS, ETC., OUT-
15 SIDE UNITED STATES.—In allocating taxable income
16 under this subsection, no amount shall be allocated to a
17 foreign organization whose assets, personnel, and office
18 and other facilities which are not attributable to the
19 United States are grossly inadequate for its activities
20 outside the United States.

21 “(7) INFORMATION NECESSARY FOR CONSIDERA-
22 TION OF FACTORS.—In the case of any transaction to
23 which paragraph (2) (A) applies, if—

24 “(A) the information submitted with respect
25 to the group of organizations is insufficient for the

proper application of the method of allocation set forth in the first sentence of such paragraph, and

“(B) upon request of the Secretary or his delegate, such group fails to furnish such additional information with respect to such transaction as may be reasonably supplied,

the Secretary or his delegate may estimate the taxable income arising from such transaction and may allocate such taxable income among the members of the group or to any single member thereof.

“(8) TREATMENT OF FOREIGN TAXES.—

“(A) For purposes of this subsection, taxable income shall be determined without regard to any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States.

“(B) Where the application of this subsection results in a decrease in the taxable income of any foreign organization and an increase in the taxable income of any domestic organization, then any of the taxes referred to in subparagraph (A) paid by such foreign organization and attributable to the taxable income so transferred shall be treated for purposes of this chapter—

1 “(i) as paid by such domestic organiza-
2 tion, and

3 “(ii) as not paid by such foreign organi-
4 zation.”

5 (b) CLERICAL AMENDMENT.—Section 482 is amended
6 by striking out “In any case of two or more organizations”
7 and inserting in lieu thereof the following:

8 “(a) GENERAL RULE.—In the case of two or more
9 organizations”.

10 (c) EFFECTIVE DATE.—The amendments made by
11 this section shall apply with respect to taxable years begin-
12 ning after December 31, 1962.

13 **SEC. 7. DISTRIBUTIONS OF FOREIGN PERSONAL HOLD-**
14 **ING COMPANY INCOME.**

15 (a) DEFINITION OF FOREIGN PERSONAL HOLDING
16 COMPANY.—So much of subsection (a) of section 552 (re-
17 lating to definition of foreign personal holding company) as
18 precedes paragraph (2) is amended to read as follows:

19 “(a) GENERAL RULE.—For purposes of this subtitle,
20 the term ‘foreign personal holding company’ for a taxable
21 year beginning after December 31, 1962, means any for-
22 eign corporation if—

23 “(1) GROSS INCOME REQUIREMENT.—At least 20
24 percent of its gross income (as defined in section 555
25 (a)) for the taxable year is foreign personal holding

1 company income (as defined in section 553). For
 2 purposes of this paragraph, there shall be included in
 3 the gross income the amount includible therein as a
 4 dividend by reason of the application of section 555 (c)
 5 (2) ; and”.

6 (b) AMOUNT OF UNDISTRIBUTED INCOME.—Subsec-
 7 tion (a) of section 556 (relating to undistributed foreign
 8 personal holding company income) is amended to read as
 9 follows:

10 “(a) DEFINITION.—For purposes of this part—

11 “(1) If the foreign personal holding company in-
 12 come of a foreign personal holding company exceeds
 13 80 percent of its gross income, the ‘undistributed for-
 14 eign personal holding company income’ of such com-
 15 pany is its taxable income adjusted in the manner
 16 provided in subsection (b), minus the dividends paid
 17 deduction (as defined in section 561).

18 “(2) If the foreign personal holding company
 19 income of a foreign personal holding company does not
 20 exceed 80 percent of its gross income, the ‘undistributed
 21 foreign personal holding company income’ of such com-
 22 pany is that amount which bears the same ratio to—

23 “(A) its taxable income adjusted in the man-
 24 ner provided in subsection (b), minus the dividends
 25 paid deduction (as defined in section 561), as

1 “(B) its foreign personal holding company in-
2 come bears to its gross income.”

3 (c) EFFECTIVE DATE.—The amendments made by this
4 section shall apply only in respect of taxable years of
5 foreign corporations beginning after December 31, 1962.

6 **SEC. 8. MUTUAL SAVINGS BANKS, ETC.**

7 (a) RESERVES FOR LOSSES ON LOANS.—Section 593
8 is amended to read as follows:

9 **“SEC. 593. RESERVES FOR LOSSES ON LOANS.**

10 “(a) ORGANIZATIONS TO WHICH SECTION APPLIES.—
11 This section shall apply to any mutual savings bank not
12 having capital stock represented by shares, domestic building
13 and loan association, or cooperative bank without capital
14 stock organized and operated for mutual purposes and with-
15 out profit.

16 “(b) ADDITION TO RESERVES FOR BAD DEBTS.—

17 “(1) IN GENERAL.—For purposes of section 166

18 (c), the reasonable addition for the taxable year to the
19 reserve for bad debts of any taxpayer described in sub-
20 section (a) shall be an amount equal to the sum of—

21 “(A) the amount determined under section
22 166(c) to be a reasonable addition to the reserve
23 for losses on nonqualifying loans, plus

24 “(B) the amount determined by the taxpayer
25 to be a reasonable addition to the reserve for losses

on qualifying real property loans, but such amount shall not exceed the amount determined under paragraph (2), (3), or (4), whichever amount is the largest.

“(2) 60 PERCENT OF TAXABLE INCOME METHOD.—The amount determined under this paragraph for the taxable year shall be the excess of—

“(A) an amount equal to 60 percent of the taxable income for such year, over

“(B) the amount referred to in paragraph (1) (A) for such year.

For purposes of this paragraph, taxable income shall be computed (i) by excluding from gross income any amount included therein by reason of subsection (f), and (ii) without regard to any deduction allowable for any addition to the reserve for bad debts.

“(3) 3 PERCENT OF REAL PROPERTY LOANS METHOD.—The amount determined under this paragraph for the taxable year shall be an amount equal to the amount necessary to increase the balance (as of the close of the taxable year) of the reserve for losses on qualifying real property loans to 3 percent of such loans outstanding at such time.

“(4) EXPERIENCE METHOD.—The amount determined under this paragraph for the taxable year shall

1 be an amount equal to the amount determined under
2 section 166 (c) (without regard to this subsection) to
3 be a reasonable addition to the reserve for losses on
4 qualifying real property loans.

5 “(c) TREATMENT OF RESERVES FOR BAD DEBTS.—

6 “(1) ESTABLISHMENT OF RESERVES.—Each tax-
7 payer described in subsection (a) which uses the reserve
8 method of accounting for bad debts shall establish and
9 maintain a reserve for losses on qualifying real property
10 loans, a reserve for losses on nonqualifying loans, and a
11 supplemental reserve for losses on loans. For purposes
12 of this title, such reserves shall be treated as reserves
13 for bad debts, but no deduction shall be allowed for any
14 addition to the supplemental reserve for losses on loans.

15 “(2) ALLOCATION OF PRE-1963 RESERVES.—For
16 purposes of this section, the pre-1963 reserves shall, as
17 of the close of December 31, 1962, be allocated to, and
18 constitute the opening balance of—

19 “(A) the reserve for losses on nonqualifying
20 loans,

21 “(B) the reserve for losses on qualifying real
22 property loans, and

23 “(C) the supplemental reserve for losses on
24 loans.

1 “(3) METHOD OF ALLOCATION.—The allocation
2 provided by paragraph (2) shall be made—

3 “(A) first, to the reserve described in para-
4 graph (2) (A), to the extent such reserve is not
5 increased above the amount which would be a
6 reasonable addition under section 166(c) for a
7 period in which the nonqualifying loans increased
8 from zero to the amount thereof outstanding at the
9 close of December 31, 1962;

10 “(B) second, to the reserve described in para-
11 graph (2) (B), to the extent such reserve is not
12 increased above the amount which would be deter-
13 mined under paragraph (3) or (4) of subsection
14 (b) (whichever such amount is the larger) for a
15 period in which the qualifying real property loans
16 increased from zero to the amount thereof outstand-
17 ing at the close of December 31, 1962; and

18 “(C) then to the supplemental reserve for
19 losses on loans.

20 “(4) PRE-1963 RESERVES DEFINED.—For purposes
21 of this subsection, the term ‘pre-1963 reserves’ means
22 the net amount, determined as of the close of December
23 31, 1962 (after applying subsection (d) (1)), accumu-
24 lated in the reserve for bad debts pursuant to section

1 166(c) (or the corresponding provisions of prior reve-
2 nue laws) for taxable years beginning after December
3 31, 1951.

4 “(5) CHARGING OF BAD DEBTS TO RESERVES.—
5 Any debt becoming worthless or partially worthless
6 in respect of a qualifying real property loan shall be
7 charged to the reserve for losses on such loans, and any
8 debt becoming worthless or partially worthless in re-
9 spect of a nonqualifying loan shall be charged to the
10 reserve for losses on nonqualifying loans; except that
11 any such debt may, at the election of the taxpayer, be
12 charged in whole or in part to the supplemental reserve
13 for losses on loans.

14 “(d) TAXABLE YEARS BEGINNING IN 1962 AND END-
15 ING IN 1963.—In the case of a taxable year beginning before
16 January 1, 1963, and ending after December 31, 1962, of
17 a taxpayer described in subsection (a) which uses the
18 reserve method of accounting for bad debts, the taxable in-
19 come shall be the sum of—

20 “(1) that portion of the taxable income allocable
21 to the part of the taxable year occurring before January
22 1, 1963, reduced by the amount of the deduction for an
23 addition to a reserve for bad debts which would be allow-
24 able under section 166(c) (without regard to the

amendments made by section 8 of the Revenue Act of 1962) if such part year constituted a taxable year, plus

“(2) that portion of the taxable income allocable to the part of the taxable year occurring after December 31, 1962, reduced by the amount of the deduction for an addition to a reserve for bad debts which would be allowed under section 166 (c) (taking into account the amendments made by section 8 of the Revenue Act of 1962) if such part year constituted a taxable year.

For purposes of the preceding sentence, the taxable income shall be determined without regard to any deduction under section 166 (c), and the portion thereof allocable to each part year shall be determined on the basis of the ratio which the number of days in such part year bears to the number of days in the entire taxable year.

“(e) LOANS DEFINED.—For purposes of this section—

“(1) QUALIFYING REAL PROPERTY LOANS.—The term ‘qualifying real property loan’ means any loan secured by an interest in improved real property or secured by an interest in real property which is to be improved out of the proceeds of the loan, but such term does not include—

“(A) any loan evidenced by a security (as defined in section 165 (g) (2) (C)) ;

“(B) any loan, whether or not evidenced by a

1 security (as defined in section 165(g) (2) (C)),
2 the primary obligor on which is—

3 “(i) a government or political subdivision
4 or instrumentality thereof;

5 “(ii) a bank (as defined in section 581) ;
6 or

7 “(iii) another member of the same affil-
8 iated group;

9 “(C) any loan, to the extent secured by a
10 deposit in or share of the taxpayer; or

11 “(D) any loan which, within a 60-day period
12 beginning in one taxable year of the creditor and
13 ending in its next taxable year, is made or acquired
14 and then repaid or disposed of, unless the trans-
15 actions by which such loan was made or acquired
16 and then repaid or disposed of are established to be
17 for bona fide business purposes.

18 For purposes of subparagraph (B) (iii), the term
19 ‘affiliated group’ has the meaning assigned to such term
20 by section 1504 (a) ; except that (i) the phrase ‘more
21 than 50 percent’ shall be substituted for the phrase ‘at
22 least 80 percent’ each place it appears in section 1504
23 (a), and (ii) all corporations shall be treated as
24 includible corporations (without any exclusion under
25 section 1504 (b)).

1 “(2) NONQUALIFYING LOANS.—The term ‘non-
2 qualifying loan’ means any loan which is not a quali-
3 fying real property loan.

4 “(3) LOAN.—The term ‘loan’ means debt, as the
5 term ‘debt’ is used in section 166.

6 “(f) DISTRIBUTIONS TO SHAREHOLDERS.—

7 “(1) IN GENERAL.—For purposes of this chapter,
8 any distribution of property (as defined in section 317
9 (a)) by a domestic building and loan association to a
10 shareholder with respect to its stock, if such distribution
11 is not allowable as a deduction under section 591, shall
12 be treated as made—

13 “(A) first out of its earnings and profits accu-
14 mulated in taxable years beginning after December
15 31, 1951, to the extent thereof,

16 “(B) then out of the reserve for losses on quali-
17 fying real property loans, to the extent additions
18 to such reserve exceed the additions which would
19 have been allowed under subsection (b) (4) ,

20 “(C) then out of the supplemental reserve for
21 losses on loans, to the extent thereof,

22 “(D) then out of such other accounts as may
23 be proper.

24 This paragraph shall apply in the case of any distribu-
25 tion in redemption of stock or in partial or complete
26 liquidation of the association, except that any such distri-

1 bution shall be treated as made first out of the amount
2 referred to in subparagraph (B), second out of the
3 amount referred to in subparagraph (C), third out of
4 the amount referred to in subparagraph (A), and then
5 out of such other accounts as may be proper.

6 “(2) AMOUNTS CHARGED TO RESERVE ACCOUNTS
7 AND INCLUDED IN GROSS INCOME.—If any distribution
8 is treated under paragraph (1) as having been made
9 out of the reserves described in subparagraphs (B) and
10 (C) of such paragraph, the amount charged against
11 such reserve shall be the amount which, when reduced
12 by the amount of tax imposed under this chapter and
13 attributable to the inclusion of such amount in gross
14 income, is equal to the amount of such distribution; and
15 the amount so charged against such reserve shall be
16 included in gross income of the taxpayer.

17 “(3) SPECIAL RULES.—

18 “(A) For purposes of paragraph (1) (B),
19 additions to the reserve for losses on qualifying real
20 property loans for the taxable year in which the
21 distribution occurs shall be taken into account.

22 “(B) For purposes of computing under this
23 section the amount of a reasonable addition to the
24 reserve for losses on qualifying real property loans
25 for any taxable year, any amount charged during

any year to such reserve pursuant to the provisions of paragraph (2) shall not be taken into account.”

(b) FORECLOSURE ON PROPERTY SECURING LOANS.—

Part II of subchapter H of chapter 1 (relating to mutual savings banks, etc.) is amended by adding at the end thereof the following new section:

“SEC. 595. FORECLOSURE ON PROPERTY SECURING LOANS.

“(a) NONRECOGNITION OF GAIN OR LOSS AS A RESULT OF FORECLOSURE.—In the case of a creditor which is an organization described in section 593 (a), no gain or loss shall be recognized, and no debt shall be considered as becoming worthless or partially worthless, as the result of such organization having bid in at foreclosure, or having otherwise reduced to ownership or possession by agreement or process of law, any property which was security for the payment of any indebtedness.

“(b) CHARACTER OF PROPERTY.—For purposes of sections 166 and 1221, any property acquired in a transaction with respect to which gain or loss to an organization was not recognized by reason of subsection (a) shall be considered as property having the same characteristics as the indebtedness for which such property was security. Any amount realized by such organization with respect to such property shall be treated for purposes of this chapter as a payment on account of such indebtedness, and any loss with respect thereto shall be treated as a bad debt to which the

1 provisions of section 166 (relating to allowance of a deduc-
2 tion for bad debts) apply.

3 “(c) BASIS.—The basis of any property to which sub-
4 section (a) applies shall be the basis of the indebtedness for
5 which such property was security (determined as of the date
6 of the acquisition of such property), properly increased for
7 costs of acquisition.

8 “(d) REGULATORY AUTHORITY.—The Secretary or his
9 delegate shall prescribe such regulations as he may deem
10 necessary to carry out the purposes of this section.”

11 (c) DEFINITION OF DOMESTIC BUILDING AND LOAN
12 ASSOCIATION.—Paragraph (19) of section 7701 (a) (def-
13 inition of domestic building and loan association) is amended
14 to read as follows:

15 “(19) DOMESTIC BUILDING AND LOAN ASSOCIA-
16 TION.—The term ‘domestic building and loan association’
17 means a domestic building and loan association, a do-
18 mestic savings and loan association, and a Federal sav-
19 ings and loan association, which—

20 “(A) is an insured institution (within the
21 meaning of section 401 (a) of the National Housing
22 Act (12 U.S.C., sec. 1724 (a)), or

23 “(B) is subject by law to supervision and
24 examination by State or Federal authority having
25 supervision over such associations,

26 if substantially all of its business consists of accepting

savings and investing the proceeds (i) in loans secured by an interest in real property which is (or, from the proceeds of the loan, will become) residential real property, and (ii) in other loans, to the extent such other loans would be authorized to be made by a Federal savings and loan association under section 5(c) of the Home Owners' Loan Act, as amended (12 U.S.C., sec. 1464 (c)).”

(d) CLERICAL AMENDMENTS.—The table of sections for part II of subchapter H of chapter 1 is amended—

(1) by striking out the third item and inserting in lieu thereof the following:

“Sec. 593. Reserves for losses on loans.”

and

(2) by adding at the end thereof the following:

“Sec. 595. Foreclosure on property securing loans.”

(e) REPEAL OF EXEMPTION FROM COMMUNICATIONS AND TRANSPORTATION OF PERSONS TAXES.—Notwithstanding any other provision of law, Federal savings and loan associations shall not be exempt as such from the taxes imposed by section 4251 (relating to excise tax on communications) and section 4261 (relating to excise tax on transportation of persons) of the Internal Revenue Code of 1954.

(f) EFFECTIVE DATES.—

(1) The amendment made by subsection (a) shall

1 apply to taxable years ending after December 31, 1962,
2 except that section 593 (f) of the Internal Revenue
3 Code of 1954 shall apply to distributions after Decem-
4 ber 31, 1962, in taxable years ending after such date.

5 (2) The amendment made by subsection (b) shall
6 apply to transactions described in section 595 (a) of the
7 Internal Revenue Code of 1954 occurring after Decem-
8 ber 31, 1962, in taxable years ending after such date.

9 (3) Subsection (e) of this section shall apply—

10 (A) in the case of the tax imposed by section
11 4251 of the Internal Revenue Code of 1954, with
12 respect to amounts paid pursuant to bills rendered
13 after June 30, 1962; and

14 (B) in the case of the tax imposed by section
15 4261 of such Code, with respect to transportation
16 beginning after June 30, 1962.

17 **SEC. 9. DISTRIBUTIONS BY FOREIGN TRUSTS.**

18 (a) DEFINITIONS.—

19 (1) INCOME OF FOREIGN TRUST.—Section 643 (a)
20 (6) (relating to modifications taken into account in com-
21 puting distributable net income) is amended to read as
22 follows:

23 “(6) INCOME OF FOREIGN TRUST.—In the case of
24 a foreign trust—

25 “(A) There shall be included the amounts of

1 gross income from sources without the United States,
2 reduced by any amounts which would be deductible
3 in respect of disbursements allocable to such income
4 but for the provisions of section 265 (1) (relating
5 to disallowance of certain deductions) .

6 “(B) Gross income from sources within the
7 United States shall be determined without regard
8 to section 894 (relating to income exempt under
9 treaty) .

10 “(C) Subsection (a) (3) of this section shall
11 not apply to a foreign trust created by a United
12 States person. In the case of such a trust, (i) there
13 shall be included gains from the sale or exchange
14 of capital assets, reduced by losses from such sales
15 or exchanges to the extent such losses do not exceed
16 gains from such sales or exchanges, and (ii) the
17 deduction under section 1202 (relating to deduction
18 for excess of capital gains over capital losses) shall
19 not be taken into account.”

20 (2) FOREIGN ESTATES AND TRUSTS.—Section 643
21 (relating to definitions) is amended by adding at the
22 end thereof the following new subsection:

23 “(d) FOREIGN TRUSTS CREATED BY UNITED STATES
24 PERSONS.—For purposes of this part, the term ‘foreign trust
25 created by a United States person’ means a foreign trust (as

1 defined in section 7701 (a) (31)) to which money or prop-
 2 erty has been transferred directly or indirectly by a United
 3 States person (as defined in section 7701 (a) (30)), or under
 4 the will of a decedent who at the date of his death was a
 5 United States citizen or resident.”

6 (b) ACCUMULATION DISTRIBUTIONS OF FOREIGN
 7 TRUSTS.—

8 (1) Section 665 (b) (relating to definitions
 9 applicable to subpart D) is amended by striking out
 10 “(b) ACCUMULATION DISTRIBUTION.—For purposes
 11 of this subpart,” and inserting in lieu thereof the fol-
 12 lowing:

13 “(b) ACCUMULATION DISTRIBUTIONS OF TRUSTS
 14 OTHER THAN CERTAIN FOREIGN TRUSTS.—For purposes of
 15 this subpart, in the case of a trust (other than a foreign trust
 16 created by a United States person),”.

17 (2) Section 665 is amended by redesignating sub-
 18 sections (c) and (d) as (d) and (e), respectively,
 19 and by inserting after subsection (b) the following
 20 new subsection:

21 “(c) ACCUMULATION DISTRIBUTION OF CERTAIN
 22 FOREIGN TRUSTS.—For purposes of this subpart, in the case
 23 of a foreign trust created by a United States person, the term
 24 ‘accumulation distribution’ for any taxable year of the trust
 25 means the amount by which the amounts specified in para-

graph (2) of section 661 (a) for such taxable year exceed distributable net income, reduced by the amounts specified in paragraph (1) of section 661 (a). For purposes of this subsection, the amount specified in paragraph (2) of section 661 (a) shall be determined without regard to section 666.

Any amount paid to a United States person which is from a payor who is not a United States person and which is derived directly or indirectly from a foreign trust created by a United States person shall be deemed in the year of payment to have been directly paid by the foreign trust."

(c) ALLOCATION OF ACCUMULATION DISTRIBUTIONS TO PRECEDING YEARS.—Section 666 (a) (relating to accumulation distribution allocated to 5 preceding years) is amended—

(1) by striking out "(a) AMOUNT ALLOCATED.—In the case of a trust" and inserting in lieu thereof the following:

"(a) AMOUNT ALLOCATED.—In the case of a trust (other than a foreign trust created by a United States person)"; and

(2) by adding at the end thereof the following new sentence:

"In the case of a foreign trust created by a United States person, this subsection shall apply to the preceding taxable years of the trust without regard to any provision of

1 the preceding sentences which would (but for this sentence)
2 limit its application to the 5 preceding taxable years.”

3 (d) AMOUNTS TREATED AS RECEIVED IN PRIOR
4 YEARS.—Section 668 (a) (relating to amounts treated as
5 received in prior taxable years) is amended by adding at
6 the end thereof the following new sentence: “Except as
7 provided in section 669, in the case of a foreign trust created
8 by a United States person the preceding sentence shall not
9 apply to any beneficiary who is a United States person.”

10 (e) SPECIAL RULES FOR FOREIGN TRUSTS.—Subpart
11 D of part I of subchapter J of chapter 1 (relating to treat-
12 ment of excess distributions by trusts) is amended by adding
13 at the end thereof the following new section:

14 “SEC. 669. SPECIAL RULES APPLICABLE TO CERTAIN FOR-
15 EIGN TRUSTS.

16 “(a) LIMITATION ON TAX.—

17 “(1) GENERAL RULE.—At the election of a bene-
18 ficiary who is a United States person (as defined in
19 section 7701 (a) (30)) and who satisfies the require-
20 ments of subsection (b), the tax attributable to the
21 amounts treated under section 668 (a) as having been
22 received by him from a foreign trust created by a United
23 States person on the last day of a preceding taxable
24 year of the trust shall not be greater than—

1 “(A) the tax determined under the next to the
2 last sentence of section 668 (a) , or

3 “(B) the tax determined by multiplying by
4 the number of preceding taxable years of the trust,
5 on the last day of each of which an amount is
6 deemed under section 666 (a) to have been distrib-
7 uted, the average of the increase in tax attributable
8 to recomputing the beneficiary’s gross income for the
9 taxable year and each of his 2 taxable years imme-
10 diately preceding the year of the accumulation dis-
11 tribution by adding to the income of each of such
12 years an amount determined by dividing the amount
13 required to be included in income under section
14 668 (a) by such number of preceding taxable years
15 of the trust. The recomputation for the taxable year
16 shall be made without regard to the inclusion in
17 income required by section 668 (a) of any amount
18 other than pursuant to this paragraph.

19 “(2) EXCEPTIONS.—

20 “(A) When an accumulation distribution is
21 deemed under section 666 (a) to have been distrib-
22 uted on the last day of less than 3 taxable years
23 of the trust, the taxable years of the beneficiary for
24 which a recomputation is made under subsection

1 (a) (1) (B) shall equal the number of years to
2 which section 666 (a) applies, commencing with
3 the most recent taxable year of the beneficiary.

4 “(B) If a beneficiary was not alive on the last
5 day of each preceding taxable year of the trust
6 with respect to which a distribution is deemed made
7 under section 666 (a), paragraph (1) (A) of this
8 subsection shall not apply. In applying paragraph
9 (1) (B) of this subsection, no recomputation shall
10 be made for a beneficiary for a taxable year for
11 which he was not alive; if he has no preceding tax-
12 able year, the recomputation shall be made on the
13 basis of his taxable year without regard to the in-
14 clusion in income required by section 668 (a) of
15 any amount other than pursuant to paragraph
16 (1) (B).

17 “(3) EFFECT OF PRIOR ELECTION.—In comput-
18 ing the limitation on tax under paragraph (1) of this
19 subsection for any beneficiary—

20 “(A) SUBSEQUENT ELECTION UNDER PARA-
21 GRAPH (1)(A).—If an election has been made under
22 paragraph (1) (B) of this subsection, for purposes
23 of a subsequent election under paragraph (1) (A)
24 the income of any year with respect to which an

1 amount is deemed distributed to a beneficiary under
2 section 666 (a) shall include amounts previously
3 deemed distributed to such beneficiary for such
4 year as a result of an accumulation distribution with
5 respect to which an election under paragraph (1)
6 (B) was made.

7 “(B) SUBSEQUENT ELECTION UNDER PARA-
8 GRAPH (1)(B).—If with respect to an accumulation
9 distribution an election has been made under either
10 paragraph (1) (A) or paragraph (1) (B) of this
11 subsection, or the next to the last sentence of section
12 668 (a) has applied, for purposes of a subsequent
13 election under paragraph (1) (B) the number of
14 preceding taxable years of the trust with respect to
15 which an amount is deemed distributed to a benefi-
16 ciary under section 666 (a) shall be determined
17 without regard to any such year with respect to
18 which an amount was previously deemed distrib-
19 uted to such beneficiary.

20 “(b) INFORMATION REQUIREMENT.—The election of
21 a beneficiary to apply the limitations on tax provided in sub-
22 section (a) of this section shall not be effective unless the
23 beneficiary at the time of making the election supplies such
24 information with respect to the operation and accounts of the

1 trust, for each taxable year on the last day of which an
2 amount is deemed distributed under section 666 (a), as the
3 Secretary or his delegate may by regulations prescribe.”

4 (f) INFORMATION RETURNS WITH RESPECT TO FOR-
5 EIGN TRUSTS.—Subpart B of part III of subchapter A of
6 chapter 61 (relating to information concerning transactions
7 with other persons) is amended by adding at the end thereof
8 the following new section:

9 “SEC. 6047. RETURNS AS TO CREATION OF OR TRANSFERS
10 TO CERTAIN FOREIGN TRUSTS.

11 “(a) GENERAL RULE.—On or before the 90th day
12 after—

13 “(1) the creation of any foreign trust by a United
14 States person, or

15 “(2) the transfer of any money or property to a
16 foreign trust by a United States person,

17 the grantor in the case of an inter vivos trust, the fiduciary
18 of an estate in the case of a testamentary trust, or the trans-
19 feror, as the case may be, shall make a return in compliance
20 with the provisions of subsection (b).

21 “(b) FORM AND CONTENTS OF RETURNS.—The re-
22 turns required by subsection (a) shall be in such form and
23 shall set forth, in respect of the foreign trust, such informa-
24 tion as the Secretary or his delegate prescribes by regulation

1 as necessary for carrying out the provisions of the income
2 tax laws.

3 “(c) CROSS REFERENCES.—

“ (1) For provisions relating to penalties for violations of this section, see sections 6677 and 7203.

“ (2) For definition of the term ‘foreign trust created by a United States person’, see section 643(d).”

4 (g) FAILURE TO FILE INFORMATION RETURNS.—

5 Subchapter B of chapter 68 (relating to assessable penalties)
6 is amended by adding at the end thereof the following new
7 section:

8 “SEC. 6677. FAILURE TO FILE INFORMATION RETURNS

9 WITH RESPECT TO CERTAIN FOREIGN

10 TRUSTS.

11 “(a) CIVIL PENALTY.—In addition to any criminal
12 penalty provided by law, any person required to file a return
13 under section 6047 who fails to file such return at the time
14 provided in such section, or who files a return which does not
15 show the information required pursuant to such section, shall
16 pay a penalty equal to 5 percent of the amount transferred
17 to a trust, but not more than \$1,000, unless it is shown that
18 such failure is due to reasonable cause.

19 “(b) DEFICIENCY PROCEDURES NOT TO APPLY.—

20 Subchapter B of chapter 63 (relating to deficiency proce-
21 dures for income, estate, and gift taxes) shall not apply in

1 respect of the assessment or collection of any penalty
2 imposed by subsection (a).”

3 (h) UNITED STATES PERSON DEFINED.—Section
4 7701 (a) is amended by adding at the end thereof the
5 following new paragraphs:

6 “(30) UNITED STATES PERSON.—The term
7 ‘United States person’ means—

8 “(A) a citizen or resident of the United States,

9 “(B) a domestic partnership,

10 “(C) a domestic corporation, and

11 “(D) any estate or trust (other than a foreign
12 estate or foreign trust, within the meaning of sec-
13 tion 7701 (a) (31)).

14 “(31) FOREIGN ESTATE OR TRUST.—The terms
15 ‘foreign estate’ and ‘foreign trust’ mean an estate or
16 trust, as the case may be, the income of which from
17 sources without the United States is not includible in
18 gross income under subtitle A.”

19 (i) TECHNICAL AMENDMENTS.—

20 (1) The table of sections for subpart D of sub-
21 chapter J of chapter 1 (relating to treatment of excess

distributions by trusts) is amended by adding at the end thereof

“Sec. 669. Special rules applicable to certain foreign trusts.”

(2) The table of sections for subpart B of part III of subchapter A of chapter 61 (relating to information concerning transactions with other persons) is amended by adding at the end thereof

“Sec. 6047. Returns as to creation of or transfers to certain foreign trusts.”

(3) The table of sections for subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof

“Sec. 6677. Failure to file information returns with respect to certain foreign trusts.”

(j) **EFFECTIVE DATE.**—The amendments made by this section (other than by subsections (f), (g), and (h)) shall apply with respect to distributions made in taxable years of trusts beginning after the date of the enactment of this Act.

SEC. 10. MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE, MARINE, AND CERTAIN FIRE INSURANCE COMPANIES), ETC.

(a) **IMPOSITION OF TAX.**—So much of part II of subchapter L (relating to mutual insurance companies, other than life or marine or fire insurance companies issuing per-

petual policies) of chapter 1 as precedes section 822 is amended to read as follows:

**“PART II—MUTUAL INSURANCE COMPANIES
(OTHER THAN LIFE AND CERTAIN
MARINE INSURANCE COMPANIES
AND OTHER THAN FIRE INSURANCE
COMPANIES WHICH OPERATE ON
BASIS OF PERPETUAL POLICIES OR
PREMIUM DEPOSITS)**

“Sec. 821. Tax on mutual insurance companies to which part II applies.

“Sec. 822. Determination of taxable investment income.

“Sec. 823. Determination of statutory underwriting income or loss.

“Sec. 824. Adjustments to provide protection against losses.

“Sec. 825. Unused loss deduction.

“Sec. 826. Election by reciprocal.

“SEC. 821. TAX ON MUTUAL INSURANCE COMPANIES TO WHICH PART II APPLIES.

“(a) IMPOSITION OF TAX.—A tax is hereby imposed for each taxable year beginning after December 31, 1962, on the mutual insurance company taxable income of every mutual insurance company (other than a life insurance company and other than a fire or marine insurance company subject to the tax imposed by section 831). Such tax shall consist of—

“(1) NORMAL TAX.—A normal tax of 25 percent of the mutual insurance company taxable income, or

50 percent of the amount by which such taxable income exceeds \$6,000, whichever is the lesser; plus

“(2) SURTAX.—A surtax of 22 percent of the mutual insurance company taxable income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) in excess of \$25,000.

“(b) MUTUAL INSURANCE COMPANY TAXABLE INCOME DEFINED.—For purposes of this part, the term ‘mutual insurance company taxable income’ means, with respect to any taxable year, the amount by which—

“(1) the sum of—

“(A) the taxable investment income (as defined in section 822 (a) (1)),

“(B) the statutory underwriting income (as defined in section 823 (a) (1)), and

“(C) the amounts required by section 824 (d) to be subtracted from the protection against loss account, exceeds

“(2) the sum of—

“(A) the investment loss (as defined in section 822 (a) (2)),

“(B) the statutory underwriting loss (as defined in section 823 (a) (2)), and

1 “(C) the unused loss deduction provided by
2 section 825 (a) .

3 “(c) ALTERNATIVE TAX FOR CERTAIN SMALL COM-
4 PANIES.—

5 “(1) IMPOSITION OF TAX.—In the case of taxable
6 years beginning after December 31, 1962, there is here-
7 by imposed for each taxable year on the income of each
8 mutual insurance company to which this subsection
9 applies a tax (which shall be in lieu of the tax imposed
10 by subsection (a)) computed as follows:

11 “(A) NORMAL TAX.—A normal tax of 25
12 percent of the taxable investment income, or 50
13 percent of the amount by which such taxable in-
14 come exceeds \$3,000, whichever is the lesser; plus

15 “(B) SURTAX.—A surtax of 22 percent of the
16 taxable investment income (computed without re-
17 gard to the deduction provided in section 242 for
18 partially tax-exempt interest) in excess of \$25,000.

19 “(2) GROSS AMOUNT RECEIVED, OVER \$75,000
20 BUT LESS THAN \$125,000.—If the gross amount re-
21 ceived during the taxable year from the items described
22 in section 822 (b) (other than paragraph (1) (D)
23 thereof) and premiums (including deposits and as-
24 sessments) is over \$75,000 but less than \$125,000, the
25 tax imposed by paragraph (1) shall be reduced to an

1 amount which bears the same proportion to the amount
2 of the tax determined under paragraph (1) as the
3 excess over \$75,000 of such gross amount received bears
4 to \$50,000.

5 “(3) COMPANIES TO WHICH SUBSECTION AP-
6 PLIES.—

7 “(A) IN GENERAL.—Except as provided in
8 subparagraph (B), this subsection shall apply to
9 every mutual insurance company (other than a life
10 insurance company and other than a fire or marine
11 insurance company subject to the tax imposed by
12 section 831) which received during the taxable year
13 from the items described in section 822 (b) (other
14 than paragraph (1) (D) thereof) and premiums
15 (including deposits and assessments) a gross
16 amount in excess of \$75,000 but not in excess of
17 \$300,000.

18 “(B) EXCEPTIONS.—This subsection shall not
19 apply to a mutual insurance company for the tax-
20 able year if—

21 “(i) there is in effect an election by such
22 company made under subsection (d) to be tax-
23 able under subsection (a) ; or

24 “(ii) there is any amount in the protection

1 against loss account at the beginning of the
2 taxable year.

3 “(d) ELECTION TO INCLUDE STATUTORY UNDER-
4 WRITING INCOME OR LOSS.—

5 “(1) IN GENERAL.—Any mutual insurance com-
6 pany which is subject to the tax imposed by subsection
7 (c) may elect, in such manner and at such time as the
8 Secretary or his delegate may by regulations prescribe,
9 to be subject to the tax imposed by subsection (a).

10 “(2) EFFECT OF ELECTION.—If an election is made
11 under paragraph (1), the electing company shall be
12 subject to the tax imposed by subsection (a) (and shall
13 not be subject to the tax imposed by subsection (c))
14 for the first taxable year for which such election is made
15 and for all taxable years thereafter unless the Secretary
16 or his delegate consents to a revocation of such election.

17 “(e) NO UNITED STATES INSURANCE BUSINESS.—
18 Foreign mutual insurance companies (other than a life
19 insurance company and other than a fire or marine insurance
20 company subject to the tax imposed by section 831) not
21 carrying on an insurance business within the United States
22 shall not be subject to this part but shall be taxable as other
23 foreign corporations.

1 “(f) CROSS REFERENCES.—

 “(1) For exemption from tax of certain mutual insurance companies, see section 501(c)(15).

 “(2) For alternative tax in case of capital gains, see section 1201(a).”

2 (b) TAXABLE INVESTMENT INCOME.—

3 (1) IN GENERAL.—Section 822 (relating to de-
4 termination of mutual insurance company taxable
5 income) is amended by striking out the heading and sub-
6 section (a) and inserting in lieu thereof the following:

7 “SEC. 822. DETERMINATION OF TAXABLE INVESTMENT
8 INCOME.

9 “(a) DEFINITIONS.—For purposes of this part—

10 “(1) The term ‘taxable investment income’ means
11 the gross investment income, minus the deductions pro-
12 vided in subsection (c).

13 “(2) The term ‘investment loss’ means the amount
14 by which the deductions provided in subsection (c)
15 exceed the gross investment income.”

16 (2) CONFORMING AMENDMENTS.—Subsections (c)
17 and (e) of section 822 are each amended by striking
18 out “mutual insurance company taxable income” each
19 place it appears and inserting in lieu thereof “taxable
20 investment income”.

1 (3) DIVIDENDS RECEIVED DEDUCTION.—Section
 2 822 (c) (7) (relating to special deductions) is amended
 3 by adding at the end thereof the following new sentence:
 4 “In applying section 246 (b) (relating to limitation on
 5 aggregate amount of deductions for dividends received)
 6 for purposes of this paragraph, the reference in such
 7 section to ‘taxable income’ shall be treated as a reference
 8 to ‘taxable investment income’.”

9 (4) REDESIGNATION OF SECTION 823.—Part II of
 10 subchapter L of chapter 1 is amended by striking out
 11 “SEC. 823. OTHER DEFINITIONS.

12 “‘For purposes of this part—”,
 13 and inserting in lieu thereof (at the end of section 822)
 14 the following:

15 “(f) DEFINITIONS.—For purposes of this part—”.

16 (c) STATUTORY UNDERWRITING INCOME OR LOSS.—
 17 Part II of subchapter L of chapter 1 is amended by adding
 18 after section 822 (f) (as redesignated by subsection (b) (4)
 19 of this section) the following new sections:

20 “SEC. 823. DETERMINATION OF STATUTORY UNDERWRIT-
 21 ING INCOME OR LOSS.

22 “(a) IN GENERAL.—For purposes of this part—

23 “(1) The term ‘statutory underwriting income’
 24 means the amount by which—

25 “(A) the gross income which would be taken

1 into account in computing taxable income under
2 section 832 if the taxpayer were subject to the tax
3 imposed by section 831, reduced by the gross in-
4 vestment income, exceeds

5 “(B) the sum of (i) the deductions which
6 would be taken into account in computing taxable
7 income if the taxpayer were subject to the tax im-
8 posed by section 831, reduced by the deductions
9 provided in section 822 (c), plus (ii) the deductions
10 provided in subsection (c) and section 824 (a).

11 “(2) The term ‘statutory underwriting loss’ means
12 the excess of the amount referred to in paragraph
13 (1) (B) over the amount referred to in paragraph
14 (1) (A).

15 “(b) MODIFICATIONS.—In applying subsection (a)—

16 “(1) NET OPERATING LOSS DEDUCTION.—The de-
17 duction for net operating losses provided in section 172
18 shall not be allowed.

19 “(2) INTERINSURERS.—In the case of a mutual in-
20 surance company which is an interinsurer or reciprocal
21 underwriter—

22 “(A) there shall be allowed as a deduction the
23 increase for the taxable year in savings credited to
24 subscriber accounts, or

25 “(B) there shall be included as an item of

1 gross income the decrease for the taxable year in
2 savings credited to subscriber accounts.

3 For purposes of the preceding sentence, the term 'sav-
4 ings credited to subscriber accounts' means such portion
5 of the surplus as is credited to the individual accounts
6 of subscribers before the 16th day of the third month
7 following the close of the taxable year, but only if the
8 company would be obligated to pay such amount
9 promptly to such subscriber if he terminated his con-
10 tract at the close of the company's taxable year. For
11 purposes of determining his taxable income, the sub-
12 scriber shall treat any such savings credited to his ac-
13 count as a dividend paid or declared.

14 “(c) SPECIAL DEDUCTION FOR SMALL COMPANY
15 HAVING GROSS AMOUNT OF LESS THAN \$900,000.—

16 “(1) IN GENERAL.—If the gross amount received
17 during the taxable year by a taxpayer subject to the tax
18 imposed by section 821 (a) from the items described
19 in section 822 (b) (other than paragraph (1) (D)
20 thereof) and premiums (including deposits and assess-
21 ments) does not equal or exceed \$900,000, then in
22 determining the statutory underwriting income or loss
23 for the taxable year there shall be allowed an additional
24 deduction of \$6,000; except that if such gross amount

1 exceeds \$300,000, such additional deduction shall be
2 equal to 1 percent of the amount by which \$900,000
3 exceeds such gross amount.

4 “(2) LIMITATION.—The amount of the deduction
5 allowed under paragraph (1) shall not exceed the
6 statutory underwriting income for the taxable year,
7 computed without regard to any deduction under this
8 subsection or section 824 (a) .

9 **“SEC. 824. ADJUSTMENTS TO PROVIDE PROTECTION**
10 **AGAINST LOSSES.**

11 “(a) ALLOWANCE OF DEDUCTION.—

12 “(1) IN GENERAL.—In determining the statutory
13 underwriting income or loss for any taxable year there
14 shall be allowed as a deduction the sum of—

15 “(A) an amount equal to 1 percent of the losses
16 incurred during the taxable year (as determined
17 under section 832 (b) (5)) , plus

18 “(B) an amount equal to 25 percent of the
19 underwriting gain for the taxable year, plus

20 “(C) if the concentrated windstorm, etc., pre-
21 mium percentage for the taxable year exceeds 50
22 percent, an amount determined by applying so much
23 of such percentage as exceeds 50 percent to the
24 underwriting gain for the taxable year.

1 For purposes of this paragraph, the term ‘under-
2 writing gain’ means statutory underwriting income, com-
3 puted without any deduction under this subsection.

4 “(2) SPECIAL RULE FOR COMPANIES HAVING CON-
5 CENTRATED WINDSTORM, ETC., RISKS.—For purposes
6 of paragraph (1) (C), the term ‘concentrated wind-
7 storm, etc., premium percentage’ means, with respect to
8 any taxable year, the percentage obtained by dividing—

9 “(A) the amount of the premiums earned
10 on insurance contracts during the taxable year (as
11 defined in section 832 (b) (4)), to the extent at-
12 tributable to insuring against losses arising in any
13 one State from windstorm, hail, flood, earthquake,
14 or similar hazards, by

15 “(B) the amount of the premiums earned
16 on insurance contracts during the taxable year (as
17 so defined) .

18 “(b) PROTECTION AGAINST LOSS ACCOUNT.—Each
19 insurance company subject to the tax imposed by section
20 821 (a) for any taxable year shall, for purposes of this part,
21 establish and maintain a protection against loss account.

22 “(c) ADDITIONS TO ACCOUNT.—There shall be added
23 to the protection against loss account for each taxable year
24 an amount equal to the amount allowable as a deduction for
25 the taxable year under subsection (a) (1) .

1 “(d) SUBTRACTIONS.—

2 “(1) ANNUAL SUBTRACTIONS.—After applying
3 subsection (c), there shall be subtracted for the taxable
4 year from the protection against loss account—

5 “(A) first, an amount equal to the excess of
6 the statutory underwriting loss for the taxable year
7 over the underwriting loss (as defined in paragraph
8 (6)) for the taxable year,

9 “(B) then, the amount (if any) by which—

10 “(i) the sum of the investment loss for
11 such year and the underwriting loss for such
12 year, exceeds

13 “(ii) the sum of the statutory underwrit-
14 ing income for such taxable year and the taxable
15 investment income for such taxable year,

16 “(C) next (in the order in which the losses
17 occurred), amounts equal to the unused loss carry-
18 overs to such year,

19 “(D) next, any amount remaining which was
20 added to the account for the fifth preceding taxable
21 year, minus one-half of the amount remaining in the
22 account for such taxable year which was added
23 by reason of subsection (a) (1) (B), and

24 “(E) finally, the amount by which the total

1 amount in the account exceeds whichever of the
2 following is the greater:

3 “(i) 10 percent of premiums earned on in-
4 surance contracts during the taxable year (as
5 defined in section 832 (b) (4)) less dividends
6 to policyholders (as defined in section
7 832 (c) (11)), or

8 “(ii) the total amount in the account at
9 the close of the preceding taxable year.

10 “(2) RULES FOR CEILING ON PROTECTION AGAINST
11 LOSS ACCOUNT.—For purposes of paragraph (1) (E),
12 the total amount in the account shall be determined—

13 “(A) after the application of this section with-
14 out regard to paragraph (1) (E), and

15 “(B) without taking into consideration amounts
16 remaining in the account which were added, with re-
17 spect to all taxable years, by reason of subsection
18 (a) (1) (C) .

19 “(3) PRIORITIES.—The amounts required to be
20 subtracted from the protection against loss account—

21 “(A) under subparagraphs (A), (B), and
22 (C) of paragraph (1) shall be subtracted—

23 “(i) first (on a first-in, first-out, basis)
24 from amounts in the account with respect to

1 the five preceding taxable years and the taxable
2 year, and

3 “(ii) then from amounts in the account
4 with respect to earlier years,

5 “(B) under subparagraph (E) of paragraph
6 (1) shall be subtracted only from amounts in the
7 account with respect to the taxable year, and

8 “(C) under paragraphs (A), (B), (C), and
9 (E) of paragraph (1) shall, if the amount to be
10 subtracted from the total amounts in the account
11 with respect to any taxable year is less than such
12 total, be subtracted from each of the amounts (re-
13 ferred to in subsection (a) (1)) in the account with
14 respect to such year in the proportion which each
15 bears to such total.

16 “(4) TERMINATION OF TAXABILITY UNDER SEC-
17 TION 821.—If the taxpayer is not subject to tax under
18 section 821 for any taxable year, the entire amount in
19 the account at the close of the preceding taxable year
20 shall be subtracted from the account in such preceding
21 taxable year.

22 “(5) ELECTION TO SUBTRACT AMOUNT FROM
23 ACCOUNT.—

1 “(A) A taxpayer may elect for any taxable
2 year for which it is subject to tax under section
3 821 (a) to subtract from its protection against loss
4 account any amount which, but for the application of
5 this subparagraph, would be in such account as of
6 the close of such taxable year.

7 “(B) The election provided by subparagraph
8 (A) for any taxable year shall be made (in such
9 manner and in such form as the Secretary or his
10 delegate may by regulations prescribe) after the
11 close of such taxable year and not later than the time
12 prescribed by law for filing the return (including
13 extensions thereof) for the taxable year following
14 such taxable year. Such an election, once made,
15 may not be revoked.

16 “(6) UNDERWRITING LOSS DEFINED.—For pur-
17 poses of paragraph (1), the term ‘underwriting loss’
18 means the amount by which—

19 “(A) the deductions which would be taken
20 into account in computing taxable income under
21 section 832 if the taxpayer were subject to the tax
22 imposed by section 831, reduced by the sum of (i)
23 the deductions provided in section 822 (c), and (ii)
24 the deduction for dividends to policyholders pro-
25 vided by section 832 (c) (11), exceeds

1 “(B) the amount referred to in section 823
2 (a) (1) (A).

3 **“SEC. 825. UNUSED LOSS DEDUCTION.**

4 “(a) **AMOUNT OF DEDUCTION.**—For purposes of this
5 part, the unused loss deduction for the taxable year shall be
6 an amount equal to the unused loss carryovers or carrybacks
7 to the taxable year.

8 “(b) **UNUSED LOSS DEFINED.**—For purposes of this
9 part, the term ‘unused loss’ means, with respect to any tax-
10 able year, the amount (if any) by which—

11 “(1) the sum of the statutory underwriting loss
12 and the investment loss, exceeds

13 “(2) the sum of—

14 “(A) the taxable investment income,

15 “(B) the statutory underwriting income, and

16 “(C) the amounts required by section 824 (d)
17 to be subtracted from the protection against loss
18 account.

19 “(c) **LOSS YEAR DEFINED.**—For purposes of this part,
20 the term ‘loss year’ means, with respect to any company
21 subject to the tax imposed by section 821 (a), any tax-
22 able year in which the unused loss (as defined in subsection
23 (b)) of such taxpayer is more than zero.

24 “(d) **YEARS TO WHICH CARRIED.**—The unused loss
25 for any loss year shall be—

1 “(1) an unused loss carryback to each of the 3
2 taxable years preceding the loss year, and

3 “(2) an unused loss carryover to each of the 5
4 taxable years following the loss year.

5 “(e) AMOUNT OF CARRYBACKS AND CARRYOVERS.—

6 The entire amount of the unused loss for any loss year shall
7 be carried to the earliest of the taxable years to which such
8 loss may be carried. The portion of such loss which shall
9 be carried to each of the other taxable years shall be the
10 excess (if any) of the amount of such loss over the sum
11 of the offsets (as defined in subsection (f)) for each of the
12 prior taxable years to which such loss may be carried.

13 “(f) OFFSET DEFINED.—For purposes of subsection
14 (e) , the term ‘offset’ means with respect to any taxable year
15 (hereinafter referred to as the ‘offset year’) —

16 “(1) in the case of an unused loss carryback from
17 the loss year to the offset year, the mutual insurance
18 company taxable income for the offset year; or

19 “(2) in the case of an unused loss carryover from
20 the loss year to the offset year, an amount equal to the
21 sum of—

22 “(A) the amount required to be subtracted
23 from the protection against loss account under sec-
24 tion 824 (d) (1) (C) for the offset year, plus

1 “(B) the mutual insurance company taxable
2 income for the offset year.

3 For purposes of paragraphs (1) and (2) (B), the mutual
4 insurance taxable income for the offset year shall be deter-
5 mined without regard to any unused loss carryback or carry-
6 over from the loss year or any taxable year thereafter.

7 “(g) LIMITATIONS.—For purposes of this part, an un-
8 used loss shall not be carried—

9 “(1) to or from any taxable year beginning before
10 January 1, 1963,

11 “(2) to or from any taxable year for which the
12 insurance company is not subject to the tax imposed by
13 section 821 (a), nor

14 “(3) to any taxable year if, between the loss year
15 and such taxable year, there is an intervening taxable
16 year for which the insurance company was not subject
17 to the tax imposed by section 821 (a).

18 **“SEC. 826. ELECTION BY RECIPROCAL.**

19 “(a) IN GENERAL.—Except as otherwise provided in
20 this section, any mutual insurance company which is an
21 interinsurer or reciprocal underwriter (hereinafter in this
22 section referred to as a ‘reciprocal’) subject to the taxes im-
23 posed by section 821 (a) may, under regulations prescribed
24 by the Secretary or his delegate, elect to be subject to the

1 limitation provided in subsection (b). Such election shall
2 be effective for the taxable year for which made and for all
3 succeeding taxable years, and shall not be revoked except
4 with the consent of the Secretary or his delegate.

5 “(b) LIMITATION.—The deduction for amounts paid or
6 incurred in the taxable year to the attorney-in-fact by a
7 reciprocal making the election provided in subsection (a)
8 shall be limited to, but in no case increased by, the deductions
9 of the attorney-in-fact allocable, in accordance with regula-
10 tions prescribed by the Secretary or his delegate, to the
11 income received by the attorney-in-fact from the reciprocal.

12 “(c) EXCEPTION.—An election may not be made by a
13 reciprocal under subsection (a) unless the attorney-in-fact
14 of such reciprocal—

15 “(1) is subject to the taxes imposed by section 11
16 (b) and (c) ;

17 “(2) consents in such manner as the Secretary or
18 his delegate shall prescribe by regulations to make
19 available such information as may be required during the
20 period in which the election provided in subsection (a)
21 is in effect, under regulations prescribed by the Secretary
22 or his delegate ;

23 “(3) reports the income received from the recip-

1 cal and the deductions allocable thereto under the same
2 method of accounting under which the reciprocal reports
3 deductions for amounts paid to the attorney-in-fact; and

4 “(4) files its return on the calendar year basis.

5 “(d) SPECIAL RULE.—For purposes of computing the
6 deduction provided in section 824 (a) and the additions to
7 the account provided by section 824 (c) with respect to any
8 reciprocal electing to be subject to the limitation provided
9 in subsection (b), such limitation shall not be taken into
10 account.

11 “(e) CREDIT.—Any reciprocal electing to be subject to
12 the limitation provided in subsection (b) shall be credited
13 with so much of the tax paid by the attorney-in-fact as is
14 attributable, under regulations prescribed by the Secre-
15 tary or his delegate, to the income received by the attorney-
16 in-fact from the reciprocal in such taxable year.

17 “(f) SURTAX EXEMPTION DENIED.—Any increase in
18 taxable income of a reciprocal attributable to the limitation
19 provided in subsection (b) shall be taxed without regard
20 to the surtax exemption provided in section 821 (a) (2).

21 “(g) ADJUSTMENT FOR REFUND.—If for any taxable
22 year an attorney-in-fact is allowed a credit or refund for
23 taxes paid with respect to which a reciprocal was allowed

1 a credit under subsection (e), the taxes of such reciprocal
 2 for such taxable year shall be properly adjusted under regu-
 3 lations prescribed by the Secretary or his delegate.

4 “(h) TAXES OF ATTORNEY-IN-FACT UNAFFECTED.—
 5 Nothing in this section shall increase or decrease the taxes
 6 imposed by this chapter on the income of the attorney-in-
 7 fact.”

8 (d) MUTUAL FIRE INSURANCE COMPANIES OPERAT-
 9 ING ON BASIS OF PREMIUM DEPOSITS.—

10 (1) APPLICATION OF SECTION 831(a).—Section
 11 831 (a) (imposing a tax on certain mutual marine and
 12 fire insurance companies and on stock insurance com-
 13 panies which are not life insurance companies) is
 14 amended to read as follows:

15 “(a) IMPOSITION OF TAX.—Taxes computed as pro-
 16 vided in section 11 shall be imposed for each taxable year or
 17 the taxable income of—

18 “(1) every insurance company (other than a life
 19 or mutual insurance company),

20 “(2) every mutual marine insurance company, and

21 “(3) every mutual fire insurance company—

22 “(A) exclusively issuing perpetual policies, or

23 “(B) whose principal business is the issuance
 24 of policies for which the premium deposits are the
 25 same, regardless of the length of the term for which

the policies are written, if the unabsorbed portion of such premium deposits not required for losses, expenses, or establishment of reserves is returned or credited to the policyholder on cancellation or expiration of the policy."

(2) TREATMENT OF UNABSORBED PREMIUM DEPOSITS.—Section 832 (b) (4) (relating to definition of premiums earned) is amended by adding at the end thereof the following new sentence: "For purposes of this subsection, unearned premiums of mutual fire insurance companies described in section 831 (a) (3) (B) means (with respect to the policies described in section 831 (a) (3) (B)) the amount of unabsorbed premium deposits which the company would be obligated to return to its policyholders at the close of the taxable year if all of its policies were terminated at such time; and the determination of such amount shall be based on the schedule of unabsorbed premium deposit returns for each such company then in effect."

(3) CONFORMING AMENDMENT.—Section 832 (b) (1) (C) is amended by striking out "section 831 (a)," and inserting in lieu thereof "section 831 (a) (3) (A),".

(4) ADJUSTMENT OF PREMIUM DEPOSIT.—Section 832 (c) (11) is amended to read as follows:

"(11) dividends and similar distributions paid or

1 declared to policyholders in their capacity as such, ex-
2 cept in the case of a mutual fire insurance company de-
3 scribed in section 831 (a) (3) (A). For purposes of
4 the preceding sentence, the term 'dividends and similar
5 distributions' includes amounts returned or credited to
6 policyholders on cancellation or expiration of policies
7 described in section 831 (a) (3) (B). For purposes of
8 this paragraph, the term 'paid or declared' shall be con-
9 strued according to the method of accounting regularly
10 employed in keeping the books of the insurance com-
11 pany; and".

12 (5) ADDITIONAL ITEM OF INCOME.—Section
13 832 (b) (1) is amended by striking out "and" at the end
14 of subparagraph (B), by striking out the period at the
15 end of subparagraph (C) and inserting in lieu thereof
16 ", and", and by adding at the end thereof the following
17 new subparagraph:

18 " (D) in the case of a mutual fire insurance
19 company described in section 831 (a) (3) (B), an
20 amount equal to 2 percent of the premiums earned
21 on insurance contracts during the taxable year with
22 respect to policies described in section 831 (a) (3)
23 (B) after deduction of premium deposits returned
24 or credited during the same taxable year."

25 (e) ELECTION OF CERTAIN MUTUAL COMPANIES TO

1 BE TAXED ON TOTAL INCOME.—Section 831 is amended
 2 by redesignating subsection (c) as subsection (d), and by
 3 inserting after subsection (b) the following new subsection:

4 “(c) ELECTION FOR MULTIPLE LINE COMPANY TO BE
 5 TAXED ON TOTAL INCOME.—

6 “(1) IN GENERAL.—Any mutual insurance com-
 7 pany engaged in writing marine, fire, and casualty insur-
 8 ance which for any 5-year period beginning after
 9 December 31, 1941, and ending before January 1, 1962,
 10 was subject to the tax imposed by section 831 (or the
 11 tax imposed by corresponding provisions of prior law)
 12 may elect, in such manner and at such time as the
 13 Secretary or his delegate may by regulations prescribe,
 14 to be subject to the tax imposed by section 831, whether
 15 or not marine insurance is its predominant source of
 16 premium income.

17 “(2) EFFECT OF ELECTION.—If an election is
 18 made under paragraph (1), the electing company shall
 19 (in lieu of being subject to the tax imposed by section
 20 821) be subject to the tax imposed by this section for
 21 taxable years beginning after December 31, 1961.
 22 Such election shall not be revoked except with the con-
 23 sent of the Secretary or his delegate.”

24 (f) TECHNICAL AMENDMENTS, ETC.—

25 (1) CREDIT FOR FOREIGN TAXES.—Section 841

1 (relating to credit for foreign taxes) is amended
2 by striking out “and” at the end of paragraph (1), by
3 renumbering paragraph (2) as paragraph (3), and by
4 inserting after paragraph (1) the following new para-
5 graph:

6 “(2) in the case of the tax imposed by section
7 821 (a), the mutual insurance company taxable income
8 (as defined in section 821 (b)) ; and in the case of the
9 tax imposed by section 821 (c), the taxable investment
10 income (as defined in section 822 (a)), and”.

11 (2) ADJUSTMENTS TO BASIS FOR DEPRECIATION
12 SUSTAINED.—Section 1016 (a) (3) (relating to adjust-
13 ments to basis for depreciation, etc., sustained) is
14 amended by striking out “and” at the end of subpara-
15 graph (B), by inserting “and” at the end of sub-
16 paragraph (C), and by inserting after subparagraph
17 (C) the following new subparagraph:

18 “(D) since February 28, 1913, during which
19 such property was held by a person subject to tax
20 under part II of subchapter L (or the corresponding
21 provisions of prior income tax laws), to the extent
22 that paragraph (2) does not apply,”.

23 (3) ALTERNATIVE TAX ON CAPITAL GAINS.—
24 Section 1201 (a) (relating to alternative tax on corpo-

1 rations) is amended by striking out "821 (a) (1) or
2 (b)," and inserting in lieu thereof "821 (a) or (c),".

3 (4) CLERICAL AMENDMENT.—The table of parts
4 for subchapter L is amended by striking out the portion
5 referring to part II and inserting in lieu thereof the
6 following:

"Part II. Mutual insurance companies (other than life and
certain marine insurance companies and other
than fire insurance companies which operate on
basis of perpetual policies or premium de-
posits)."

7 (g) EFFECTIVE DATE.—The amendments made by this
8 section (other than by subsection (e)) shall apply with re-
9 spect to taxable years beginning after December 31, 1962.

10 **SEC. 11. DOMESTIC CORPORATIONS RECEIVING DIVI-**
11 **DENDS FROM FOREIGN CORPORATIONS.**

12 (a) ENTIRE AMOUNT OF FOREIGN TAX TO BE TAKEN
13 INTO ACCOUNT.—

14 (1) DEFINITION OF ACCUMULATED PROFITS.—So
15 much of paragraph (1) of section 902 (c) (relating to
16 applicable rules for computing credit for corporate stock-
17 holder in foreign corporation) as precedes the semicolon
18 is amended to read as follows:

19 "(1) The term 'accumulated profits', when used in
20 this section in reference to a foreign corporation, means
21 the amount of its gains, profits, or income computed

1 without reduction by the amount of the income, war
2 profits, and excess profits taxes imposed on or with re-
3 spect to such profits or income by any foreign country
4 or any possession of the United States”.

5 (2) CONFORMING AMENDMENTS.—

6 (A) Section 902 (a) is amended by striking
7 out “which the amount of such dividends bears to
8 the amount of such accumulated profits” and insert-
9 ing in lieu thereof “which the amount of such
10 dividends (determined without regard to section
11 78) bears to the amount of such accumulated profits
12 in excess of such income, war profits, and excess
13 profits taxes (other than those deemed paid)”.

14 (B) Section 902 (b) is amended by striking
15 out “which the amount of such dividends bears to
16 the amount of such accumulated profits” and in-
17 serting in lieu thereof “which the amount of such
18 dividends bears to the amount of such accumulated
19 profits in excess of such income, war profits, and
20 excess profits taxes”.

21 (b) INCLUSION IN GROSS INCOME OF AMOUNT
22 EQUAL TO TAXES DEEMED PAID.—Part II of subchapter B
23 of chapter 1 (relating to items specifically included in gross
24 income) is amended by adding at the end thereof the fol-
25 lowing new section:

1 **“SEC. 78. DIVIDENDS RECEIVED FROM FOREIGN CORPO-**
2 **RATIONS BY DOMESTIC CORPORATIONS CHOOS-**
3 **ING FOREIGN TAX CREDIT.**

4 “If a domestic corporation chooses to have the benefits
5 of subpart A of part III of subchapter N (relating to foreign
6 tax credit) for any taxable year, an amount equal to the
7 taxes deemed to be paid by such corporation under section
8 902 (relating to credit for corporate stockholder in foreign
9 corporation) or under section 957 (a) (relating to taxes
10 paid by foreign corporation) for such taxable year shall be
11 treated for purposes of this title (other than section 245) as
12 a dividend received by such domestic corporation from the
13 foreign corporation.”

14 (c) DETERMINATION OF SOURCE OF DIVIDENDS RE-
15 CEIVED FROM CERTAIN FOREIGN CORPORATIONS.—Section
16 861 (a) (2) (B) (relating to dividends from foreign cor-
17 porations treated as income from sources within the United
18 States) is amended by striking out “to the extent exceeding
19 the amount of the deduction allowable under section 245 in
20 respect of such dividends” and inserting in lieu thereof “to
21 the extent exceeding the amount which is 100/85ths of the
22 amount of the deduction allowable under section 245 in
23 respect of such dividends”.

24 (d) REPEAL OF SECTION 902 (d).—Subsection (d)

1 (relating to special rules for certain wholly owned foreign
2 corporations) is hereby repealed.

3 (e) TECHNICAL AMENDMENTS.—

4 (1) The table of sections for part II of subchapter
5 B of chapter 1 is amended by adding at the end thereof
6 the following:

“Sec. 78. Dividends received from foreign corporations by
domestic corporations choosing foreign tax
credit.”

7 (2) Section 535 (b) (1) and the first sentence of
8 section 545 (b) (1) are each amended by striking out
9 “accrued during the taxable year,” and inserting in lieu
10 thereof “accrued during the taxable year or deemed to
11 be paid by a domestic corporation under section 902 for
12 the taxable year,”.

13 (3) Section 901 (d) is amended by adding the
14 following new paragraph:

“(4) For reduction of credit for failure of a United
States person to furnish certain information with respect
to a foreign corporation controlled by him, see section
6038.”

15 (4) Section 902 is amended by striking out subsec-
16 tion (e) and inserting in lieu thereof the following:

17 “(d) CROSS REFERENCES.—

“(1) For inclusion in gross income of an amount equal
to taxes deemed paid under this section, see section 78.

“(2) For reduction of credit with respect to dividends
paid out of accumulated profits for years for which cer-
tain information is not furnished, see section 6038.”

1 (f) EFFECTIVE DATE.—The amendments made by this
2 section shall apply—

3 (1) in respect of any distribution received by a
4 domestic corporation after December 31, 1964, and

5 (2) in respect of any distribution received by a
6 domestic corporation before January 1, 1965, in a tax-
7 able year of such corporation beginning after December
8 31, 1962, but only to the extent that such distribution
9 is made out of the accumulated profits of a foreign
10 corporation for a taxable year (of such foreign corpora-
11 tion) beginning after December 31, 1962.

12 For purposes of paragraph (2), a distribution made by a
13 foreign corporation out of its profits which are attributable
14 to a distribution received from a foreign subsidiary to which
15 section 902 (b) applies shall be treated as made out of the
16 accumulated profits of a foreign corporation for a taxable
17 year beginning before January 1, 1963, to the extent that
18 such distribution was paid out of the accumulated profits of
19 such foreign subsidiary for a taxable year beginning before
20 January 1, 1963.

1 SEC. 12. EARNED INCOME FROM SOURCES WITHOUT THE
2 UNITED STATES.

3 (a) LIMITATION ON AMOUNT AND TYPE OF INCOME
4 EXCLUDED.—Section 911 (relating to earned income from
5 sources without the United States) is amended to read as
6 follows:

7 “SEC. 911. EARNED INCOME FROM SOURCES WITHOUT
8 THE UNITED STATES.

9 “(a) GENERAL RULE.—The following items shall not
10 be included in gross income and shall be exempt from taxa-
11 tion under this subtitle:

12 “(1) BONA FIDE RESIDENT OF FOREIGN COUN-
13 TRY.—In the case of an individual citizen of the United
14 States who establishes to the satisfaction of the Secre-
15 tary or his delegate that he has been a bona fide resident
16 of a foreign country or countries for an uninterrupted
17 period which includes an entire taxable year, amounts
18 received from sources without the United States (except
19 amounts paid by the United States or any agency there-
20 of) which constitute earned income attributable to serv-
21 ices performed during such uninterrupted period. The
22 amount excluded under this paragraph for any taxable
23 year shall be computed by applying the special rules
24 contained in subsection (c).

25 “(2) PRESENCE IN FOREIGN COUNTRY FOR 17

1 MONTHS.—In the case of an individual citizen of the
2 United States who during any period of 18 consecutive
3 months is present in a foreign country or countries dur-
4 ing at least 510 full days in such period, amounts re-
5 ceived from sources without the United States (except
6 amounts paid by the United States or any agency
7 thereof) which constitute earned income attributable to
8 services performed during such 18-month period. The
9 amount excluded under this paragraph for any taxable
10 year shall be computed by applying the special rules
11 contained in subsection (c).

12 An individual shall not be allowed, as a deduction from his
13 gross income, any deductions (other than those allowed by
14 section 151, relating to personal exemptions) properly allo-
15 cable to or chargeable against amounts excluded from gross
16 income under this subsection.

17 “(b) DEFINITION OF EARNED INCOME.—For purposes
18 of this section, the term ‘earned income’ means wages, sal-
19 aries, or professional fees, and other amounts received as
20 compensation for personal services actually rendered, but
21 does not include that part of the compensation derived by
22 the taxpayer for personal services rendered by him to a
23 corporation which represents a distribution of earnings or
24 profits rather than a reasonable allowance as compensation
25 for the personal services actually rendered. In the case of

1 a taxpayer engaged in a trade or business in which both
2 personal services and capital are material income-producing
3 factors, under regulations prescribed by the Secretary or his
4 delegate, a reasonable allowance as compensation for the
5 personal services rendered by the taxpayer, not in excess of
6 30 percent of his share of the net profits of such trade or
7 business, shall be considered as earned income.

8 “(c) SPECIAL RULES.—For purposes of computing the
9 amount excludable under subsection (a), the following rules
10 shall apply:

11 “(1) LIMITATIONS ON AMOUNT OF EXCLUSION.—
12 The amount excluded from the gross income of an
13 individual under subsection (a) for any taxable year
14 shall not exceed an amount which shall be computed on
15 a daily basis at an annual rate of—

16 “(A) except as provided in subparagraph (B),
17 \$20,000 in the case of an individual who qualifies
18 under subsection (a), or

19 “(B) \$35,000 in the case of an individual who
20 qualifies under subsection (a) (1), but only with
21 respect to that portion of such taxable year occurring
22 after such individual has been a bona fide resident
23 of a foreign country or countries for an uninterrupted
24 period of 3 consecutive years.

25 “(2) ATTRIBUTION TO YEAR IN WHICH SERVICES

1 ARE PERFORMED.—For purposes of applying paragraph
2 (1), amounts received shall be considered received in
3 the taxable year in which the services to which the
4 amounts are attributable are performed.

5 “(3) TREATMENT OF COMMUNITY INCOME.—In
6 applying paragraph (1) with respect to amounts re-
7 ceived for services performed by a husband or wife
8 which are community income under community prop-
9 erty laws applicable to such income, the aggregate
10 amount excludable under subsection (a) from the gross
11 income of such husband and wife shall equal the amount
12 which would be excludable if such amounts did not con-
13 stitute such community income.

14 “(4) REQUIREMENT AS TO TIME OF RECEIPT.—
15 No amount received after the close of the taxable year
16 following the taxable year in which the services to which
17 the amounts are attributable are performed may be ex-
18 cluded under subsection (a).

19 “(5) CERTAIN AMOUNTS NOT EXCLUDABLE.—No
20 amount—

21 “(A) received as a pension or annuity, or

22 “(B) included in gross income by reason of
23 section 402 (b) (relating to taxability of benefi-
24 ciary of non-exempt trust), section 403 (c) (relat-
25 ing to taxability of beneficiary under a non-quali-

1 fied annuity), or section 403(d) (relating to
2 taxability of beneficiary under certain forfeitable
3 contracts purchased by exempt organizations),
4 may be excluded under subsection (a).

5 “(d) CROSS REFERENCES.—

**“For administrative and penal provisions relating to
the exclusion provided for in this section, see sections
6001, 6011, 6012(c), and the other provisions of subtitle F.”**

6 (b) COMPUTATION OF EMPLOYEES' CONTRIBU-
7 TIONS.—Section 72(f) (relating to special rules for comput-
8 ing employees' contributions) is amended by adding after
9 paragraph (2) the following new sentences:
10 “Paragraph (2) shall not apply to amounts which were con-
11 tributed by the employer after December 31, 1962, and
12 which would not have been includible in the gross income of
13 the employee by reason of the application of section 911 if
14 such amounts had been paid directly to the employee at the
15 time of contribution. The preceding sentence shall not apply
16 to amounts which were contributed by the employer, as de-
17 termined under regulations prescribed by the Secretary or his
18 delegate, to provide pension or annuity credits, to the extent
19 such credits are attributable to services performed before
20 January 1, 1963, and are provided pursuant to pension or
21 annuity plan provisions in existence on March 12, 1962,
22 and on that date applicable to such services.”

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years ending after December 31, 1962.

(2) AMENDMENTS TO SECTION 911.—The amendment made by subsection (a) shall apply only with respect to amounts received after December 31, 1962, and which are attributable either to—

(A) services performed after such date, or

(B) services performed on or before such date, but only if on March 12, 1962, there existed no right (whether forfeitable or nonforfeitable) to receive such amounts.

SEC. 13. CONTROLLED FOREIGN CORPORATIONS.

(a) IN GENERAL.—Part III of subchapter N of chapter 1 (relating to income from sources without the United States) is amended by adding at the end thereof the following new subpart:

“Subpart F—Controlled Foreign Corporations

“Sec. 951. Amounts included in gross income of United States persons.

“Sec. 952. Subpart F income defined.

“Sec. 953. Investment of earnings in nonqualified property.

“Sec. 954. Controlled foreign corporations.

“Sec. 955. Rules for determining stock ownership.

“Sec. 956. Exclusion from gross income of previously taxed earnings and profits.

“Sec. 957. Special rules for foreign tax credit.

“Sec. 958. Adjustments to basis of stock in controlled foreign corporations and of other property.

1 "SEC. 951. AMOUNTS INCLUDED IN GROSS INCOME OF
2 UNITED STATES PERSONS.

3 "(a) AMOUNTS INCLUDED.—

4 "(1) IN GENERAL.—If a foreign corporation is a
5 controlled corporation on any day of a taxable year be-
6 ginning after December 31, 1962, every United States
7 person (as defined in section 7701 (a) (30)) who owns
8 (within the meaning of section 955 (a)) stock in such
9 corporation on the last day, in such year, on which such
10 corporation is a controlled foreign corporation shall in-
11 clude in his gross income, for his taxable year in which
12 or with which such taxable year of the corporation
13 ends—

14 "(A) his pro rata share (determined under
15 paragraph (2)) of the corporation's subpart F
16 income for such year, and

17 "(B) his pro rata share (determined under
18 section 953 (a) (2)) of the corporation's increase
19 in earnings invested in nonqualified property for
20 such year (but only to the extent not excluded
21 from gross income under section 956 (a) (2)).

22 "(2) PRO RATA SHARE OF SUBPART F INCOME.—

23 The pro rata share referred to in paragraph (1) (A)
24 in the case of any United States person is the amount—

25 "(A) which would have been distributed with

1 respect to the stock which such person owns (with-
2 in the meaning of section 955 (a)) in such cor-
3 poration if on the last day, in its taxable year, on
4 which the corporation is a controlled foreign cor-
5 poration it had distributed pro rata to its share-
6 holders an amount (i) which bears the same ratio
7 to its subpart F income for the taxable year, as
8 (ii) the part of such year during which the corpora-
9 tion is a controlled foreign corporation bears to the
10 entire year, reduced by

11 “(B) the amount of any distribution received
12 by any other United States person during such
13 year as a dividend with respect to such stock.

14 “(3) LIMITATION ON AMOUNT OF PRO RATA
15 SHARE OF INVESTMENT IN NONQUALIFIED PROPERTY
16 INCLUDED IN GROSS INCOME.—For purposes of para-
17 graph (1) (B) , the pro rata share of any United States
18 person in the increase of the earnings of a controlled
19 foreign corporation invested in nonqualified property
20 shall not exceed an amount (A) which bears the same
21 ratio to his pro rata share of such increase (as deter-
22 mined under section 953 (a) (2)) for the taxable
23 year, as (B) the part of such year during which the
24 corporation is a controlled foreign corporation bears to
25 the entire year.

1 “(b) LESS THAN 10-PERCENT OWNERSHIP.—No per-
 2 son shall be required to include any amount in gross income
 3 under subsection (a) unless he can be considered, by apply-
 4 ing the rules of ownership of section 955 (b), as owning,
 5 directly or indirectly, on any day during the taxable year
 6 of the corporation on which it was a controlled foreign cor-
 7 poration, 10 percent or more of the total combined voting
 8 power of all classes of stock, or of the total value of shares
 9 of all classes of stock, of such corporation.

10 “(c) COORDINATION WITH ELECTION OF A FOREIGN
 11 INVESTMENT COMPANY TO DISTRIBUTE INCOME.—A
 12 United States person who, for his taxable year, is a qualified
 13 shareholder (within the meaning of section 1247 (c)) of a
 14 foreign investment company with respect to which an elec-
 15 tion under section 1247 is in effect shall not be required to
 16 include in gross income, for such taxable year, subpart F
 17 income of such company.

18 “SEC. 952. SUBPART F INCOME DEFINED.

19 “(a) IN GENERAL.—

20 “(1) ITEMS TAKEN INTO ACCOUNT.—For purposes
 21 of this subpart, the term ‘subpart F income’ means, in
 22 the case of any controlled foreign corporation, the sum
 23 of—

24 “(A) income derived from insurance of United
 25 States risks (as determined under subsection (b)),

“(B) income from United States patents,
copyrights, and exclusive formulas and processes
(as determined under subsection (c)), and

“(C) the net foreign base company income
(as determined under subsection (d)), except that
this subparagraph shall apply only in the case of a
controlled foreign corporation in which 5 or fewer
United States persons own, by applying the rules of
ownership of section 955 (b), more than 50 percent
of the total combined voting power of all classes of
stock entitled to vote.

“(2) EXCLUSION OF UNITED STATES INCOME.—
Subpart F income does not include any item includible
in gross income under this chapter (other than this sub-
part) as income derived from sources within the United
States of a foreign corporation engaged in trade or
business in the United States.

“(3) NOT TO EXCEED EARNINGS AND PROFITS.—
The subpart F income of any controlled foreign corpora-
tion for any taxable year shall not exceed the earnings
and profits of such corporation for such year.

“(b) INCOME FROM INSURANCE OF UNITED STATES
RISKS.—

“(1) GENERAL RULE.—If a controlled foreign cor-
poration receives premiums or other consideration in

1 respect of any reinsurance or the issuing of any insurance
2 or annuity contract—

3 “(A) in connection with property in, or resi-
4 dents of, the United States, or

5 “(B) in connection with property not in, or
6 nonresidents of, the United States as the result of
7 any arrangement whereby another corporation re-
8 ceives a substantially equal amount of premiums or
9 other consideration in respect of any reinsurance or
10 the issuing of any insurance or annuity contract in
11 connection with property in, or residents of, the
12 United States,

13 then for purposes of subsection (a) (1) (A), the term
14 ‘income derived from the insurance of United States
15 risks’ means that income which (subject to the modifi-
16 cations provided by subparagraphs (A), (B), and (C)
17 of paragraph (2)) would be taxed under subchapter L
18 of this chapter if such corporation were a domestic
19 corporation.

20 “(2) SPECIAL RULES.—For purposes of paragraph
21 (1)—

22 “(A) In the application of part I of subchapter
23 L, life insurance company taxable income is the
24 gain from operations as defined in section 809 (b).

1 “(B) A corporation which would, if it were a
2 domestic corporation, be taxable under part II of
3 subchapter L shall apply paragraph (1) as if it
4 were taxable under part III of subchapter L.

5 “(C) The following provisions of subchapter L
6 shall not apply:

7 “(i) Section 809 (d) (4) (operations loss
8 deduction) .

9 “(ii) Section 809 (d) (5) (certain non-
10 participating contracts) .

11 “(iii) Section 809 (d) (6) (group life,
12 accident, and health insurance) .

13 “(iv) Section 809 (d) (10) (small busi-
14 ness deduction) .

15 “(v) Section 817 (b) (gain on property
16 held on December 31, 1958, and certain sub-
17 stituted property acquired after 1958) .

18 “(vi) Section 832 (b) (5) (certain capital
19 losses) .

20 “(D) ‘Gross amount’ to the extent provided in
21 section 809 (c) (1) and (2), less ‘increase in
22 certain reserves’ as defined in section 809 (d) (2),
23 and ‘premiums earned’ as defined in section 832 (b)
24 (4) shall be taken into account only to the extent

1 they are in respect of any reinsurance or the issuing
2 of any reinsurance or the issuing of any insurance
3 or annuity contract described in paragraph (1).

4 “(E) All items of income (other than those
5 taken into account under subparagraph (D)) and
6 all items of expenses, losses, and deductions shall
7 be properly allocated or apportioned under regula-
8 tions prescribed by the Secretary or his delegate.

9 “(c) INCOME FROM UNITED STATES PATENTS, COPY-
10 RIGHTS, AND EXCLUSIVE FORMULAS AND PROCESSES.—

11 “(1) GENERAL RULE.—For purposes of subsection
12 (a) (1) (B), the term ‘income from United States
13 patents, copyrights, and exclusive formulas and proc-
14 esses’, means the amount of gross rentals, royalties, or
15 other income derived from the license, sublicense, sale,
16 exchange, use, or other means of exploitation of patents,
17 copyrights, and exclusive formulas and processes—

18 “(A) substantially developed, created, or pro-
19 duced in the United States, or

20 “(B) acquired from any United States person
21 which, directly or indirectly, owns or controls, or
22 is owned or controlled by, or is under common
23 ownership or control with, the controlled foreign
24 corporation,

1 less the cost and expense allowance defined in para-
2 graph (2).

3 “(2) COST AND EXPENSE ALLOWANCE.—An al-
4 lowance shall be made, in accordance with regulations
5 prescribed by the Secretary or his delegate, for ordinary
6 and necessary expenses incurred by the controlled foreign
7 corporation in the receipt or production of the income
8 described in paragraph (1), including taxes and any
9 amortization or depreciation of the cost to such corpo-
10 ration of such property or rights described in paragraph
11 (1), but not including any production, manufacturing,
12 or similar expenses incurred in the use or other means
13 of exploitation of such property or rights.

14 “(3) DETERMINATION OF INCOME FROM USE.—
15 The income from use or other means of exploitation by
16 the controlled foreign corporation of the property or
17 right described in paragraph (1) shall be the amount
18 which would be obtained as a gross rent, royalty, or
19 other payment in an arm's length transaction with an
20 unrelated person for similar use or exploitation, of the
21 property or right.

22 “(d) NET FOREIGN BASE COMPANY INCOME.—For
23 purposes of subsection (a) (1) (C), the term ‘net foreign
24 base company income’ means—

1 “(1) the foreign base company income for the tax-
2 able year, determined under subsection (e), reduced
3 by

4 “(2) the increase in investment in qualified prop-
5 erty in less developed countries for the taxable year,
6 determined under subsection (f).

7 “(e) FOREIGN BASE COMPANY INCOME.—

8 “(1) IN GENERAL.—For purposes of subsection
9 (d) (1), the term ‘foreign base company income’ means
10 the foreign personal holding company income (as de-
11 fined in section 553) for the taxable year, modified and
12 adjusted as provided in this subsection.

13 “(2) CERTAIN SALES INCOME INCLUDED.—The
14 term ‘foreign base company income’ includes foreign
15 base company sales income if, for the taxable year, such
16 income is equal to at least 20 percent of the gross income
17 of the foreign corporation (not including for this purpose
18 other foreign base company income under this subsec-
19 tion). For purposes of this paragraph, the term ‘foreign
20 base company sales income’ means income (whether in
21 the form of profits, commissions, fees, or otherwise)
22 derived in connection with the purchase of personal
23 property from a related person and its sale to any per-
24 son, or the purchase of personal property from any
25 person and its sale to a related person, where—

1 “(A) the property which is purchased is manu-
2 factured, produced, grown, or extracted outside
3 the country under the laws of which the controlled
4 foreign corporation is created or organized, and

5 “(B) the property is sold for use, consumption,
6 or disposition outside such foreign country.

7 For purposes of the preceding sentence, a person is a
8 related person with respect to the controlled foreign
9 corporation if he, directly or indirectly, owns or con-
10 trols, or is owned or controlled by, or is under common
11 ownership or control with, the controlled foreign
12 corporation.

13 “(3) RENTS INCLUDED WITHOUT REGARD TO 50-
14 PERCENT LIMITATION.—All rents shall be included in
15 foreign base company income without regard to whether
16 or not such rents constitute more than 50 percent of
17 gross income.

18 “(4) INSURANCE AND PATENT INCOME EX-
19 CLUDED.—The term ‘foreign base company income’ does
20 not include any income derived from insurance of United
21 States risks (as determined under subsection (b)) or
22 income from United States patents, copyrights, and ex-
23 clusive formulas and processes (as determined under
24 subsection (c)).

1 “(5) INCOME OF CERTAIN BANKS AND BANK-
2 CONTROLLED CORPORATIONS EXCLUDED.—The term
3 ‘foreign base company income’ does not include—

4 “(A) the income of any corporation de-
5 scribed in section 552(b) (relating to excep-
6 tion for banks and exempt corporations), or

7 “(B) the income of any foreign corporation
8 if 50 percent or more of the fair market value of
9 its outstanding stock is owned directly or indirectly
10 by a domestic corporation which is either organ-
11 ized under section 25(a) of the Federal Reserve
12 Act (12 U.S.C., secs. 611–631), or has an agree-
13 ment or understanding with the Board of Gover-
14 nors of the Federal Reserve System under section
15 25 of the Federal Reserve Act (12 U.S.C., secs.
16 601–604), if all of the stock (except qualifying
17 shares) of the domestic corporation is owned by a
18 national or State bank which is a member of the
19 Federal Reserve System.

20 “(6) SPECIAL RULE WHERE FOREIGN BASE COM-
21 PANY INCOME IS LESS THAN 20 PERCENT OR MORE
22 THAN 80 PERCENT OF GROSS INCOME.—For purposes
23 of this subsection—

24 “(A) If the foreign base company income
25 (determined without regard to paragraph (7))

1 is less than 20 percent of gross income, no part of
 2 the gross income of the taxable year shall be
 3 treated as foreign base company income.

4 “(B) If the foreign base company income
 5 (determined without regard to paragraph (7))
 6 exceeds 80 percent of gross income, the entire
 7 gross income of the taxable year shall be taken
 8 into account in determining foreign base company
 9 income.

10 “(7) DEDUCTIONS TO BE TAKEN INTO AC-
 11 COUNT.—The foreign base company income for the tax-
 12 able year shall be reduced so as to take into account
 13 deductions (including taxes) properly allocable to such
 14 income.

15 “(f) INVESTMENT IN QUALIFIED PROPERTY IN LESS
 16 DEVELOPED COUNTRIES.—

17 “(1) GENERAL RULE.—For purposes of subsection
 18 (d) (2), the increase in investment in qualified property
 19 in less developed countries for any taxable year is the
 20 amount by which—

21 “(A) the aggregate amount of property de-
 22 scribed in sections 953 (b) (2) (C) and (D) and
 23 property (including money) which is located out-
 24 side the United States and is ordinary and necessary
 25 for the active conduct of a qualified trade or business

1 described in section 953 (b) (3) (A) (ii) held at
2 the close of the taxable year, exceeds

3 “(B) the aggregate amount of property de-
4 scribed in subparagraph (A) held at the close of
5 the preceding taxable year.

6 “(2) INVESTMENTS AFTER CLOSE OF YEAR.—
7 Under regulations prescribed by the Secretary or his
8 delegate, a controlled foreign corporation may elect to
9 make the determinations under subparagraphs (A)
10 and (B) of paragraph (1) as of the close of the 75th
11 day after the close of each taxable year.

12 “(3) AMOUNT ATTRIBUTABLE TO PROPERTY.—
13 The amount taken into account under paragraph (1)
14 with respect to any property shall be its adjusted basis,
15 reduced by any liability to which the property is subject.

16 **“SEC. 953. INVESTMENT OF EARNINGS IN NONQUALIFIED**
17 **PROPERTY.**

18 “(a) GENERAL RULES.—For purposes of this subpart—

19 “(1) AMOUNT OF INVESTMENT.—The amount of
20 earnings of a controlled foreign corporation invested in
21 nonqualified property at the close of any taxable year
22 is the aggregate amount of such property held at the
23 close of the taxable year, to the extent such amount
24 does not exceed the sum of (A) the earnings and profits
25 for the taxable year, and (B) the earnings and profits

1 accumulated for prior taxable years beginning after
2 December 31, 1962.

3 “(2) PRO RATA SHARE OF INCREASE FOR YEAR.—

4 In the case of any United States person, the pro rata
5 share of the increase for any taxable year in the earn-
6 ings of a controlled foreign corporation invested in a
7 nonqualified property is the amount determined by sub-
8 tracting—

9 “(A) his pro rata share of the amount deter-
10 mined under paragraph (1) for the close of the
11 preceding taxable year, reduced by amounts paid
12 during the taxable year to which section 956 (c) (1)
13 applies, from

14 “(B) his pro rata share of the amount deter-
15 mined under paragraph (1) for the close of the
16 taxable year.

17 “(3) AMOUNT ATTRIBUTABLE TO PROPERTY.—

18 The amount taken into account under paragraph (1) or
19 (2) with respect to any property shall be its adjusted
20 basis, reduced by any liability to which the property
21 is subject.

22 “(b) NONQUALIFIED PROPERTY DEFINED.—For pur-
23 poses of this subpart—

24 “(1) GENERAL RULE.—The term ‘nonqualified
25 property’ means any money or other property (tangible

1 or intangible) acquired after December 31, 1962,
2 which is not qualified property.

3 “(2) QUALIFIED PROPERTY.—The term ‘qualified
4 property’ means—

5 “(A) Any money or other property which is
6 located outside the United States and is ordinary
7 and necessary for the active conduct of a qualified
8 trade or business (as determined under paragraph
9 (3)) carried on by the controlled foreign corpora-
10 tion.

11 “(B) Property which would qualify under sub-
12 paragraph (A) except for the fact that it is located
13 in the United States, but only if such property is—

14 “(i) obligations of the United States,
15 money, or deposits with persons carrying on
16 the banking business;

17 “(ii) property purchased in the United
18 States for export to, or for use in, foreign
19 countries; or

20 “(iii) any loan arising in connection with
21 the sale of property if the amount of such loan
22 outstanding at no time during the taxable year
23 exceeds the amount which would be ordinary
24 and necessary to carry on the trade or business
25 of both the lending corporation and the borrow-

1 ing United States person had the sale been
2 made between unrelated persons.

3 “(C) Stock owned by the controlled foreign
4 corporation in another controlled foreign corpora-
5 tion in which it owns at least 10 percent of the vot-
6 ing stock and 10 percent of the value of all classes of
7 stock and in which it together with four or fewer
8 United States persons, owns, directly or indirectly,
9 more than 50 percent of the voting stock (unless
10 under the laws of a less developed country such per-
11 centage of ownership is not permitted, in which
12 case such lesser percentage as is permitted) ; but this
13 subparagraph shall apply only if—

14 “(i) substantially all of the property of
15 such other controlled foreign corporation is or-
16 dinary and necessary for the active conduct of
17 a trade or business engaged in by it almost
18 wholly within a less developed country or
19 countries, and

20 “(ii) such other controlled foreign cor-
21 poration is created or organized under the laws
22 of one of such countries in which it is so en-
23 gaged.

24 “(D) Any investment which is required
25 because of restrictions imposed by a less developed

1 country, and any investment which, when made,
2 was so required and which would result in substan-
3 tial losses if withdrawn.

4 “(3) QUALIFIED TRADE OR BUSINESS.—

5 “(A) A trade or business is a qualified trade or
6 business if such trade or business (or substantially
7 the same trade or business) —

8 “(i) is carried on by the controlled foreign
9 corporation outside the United States and has
10 been so carried on by such corporation, while
11 controlled by substantially the same United
12 States persons since December 31, 1962, or
13 during the 5-year period ending with the close
14 of the preceding taxable year, or

15 “(ii) is carried on by the controlled foreign
16 corporation almost wholly within a less devel-
17 oped country or countries.

18 “(B) A trade or business which is a qualified
19 trade or business for a corporation in which the
20 controlled foreign corporation owns at least 80 per-
21 cent of the total combined voting power of all classes
22 of stock entitled to vote and at least 80 percent of

1 the total value of all classes of stock shall be treated
2 as a qualified trade or business for the controlled
3 foreign corporation if such percentage of stock was
4 owned continuously since December 31, 1962, or
5 during the 5-year period ending with the close of
6 the preceding taxable year.

7 “(4) SITUS OF CERTAIN PROPERTY.—Property
8 which is an obligation of, or pledges and guarantees
9 made with respect to obligations of, United States persons
10 shall be considered as property located in the United
11 States.

12 “(5) LESS DEVELOPED COUNTRY DEFINED.—The
13 term ‘less developed country’ means (in respect of any
14 foreign corporation) any foreign country (other than
15 an area within the Sino-Soviet bloc) or any possession
16 of the United States, with respect to which on the first
17 day of the taxable year, there is in effect an Executive
18 order by the President of the United States designating
19 such country or possession as an economically less de-
20 veloped country for purposes of this subpart. For pur-
21 poses of the preceding sentence, an oversea territory,
22 department, province, or possession may be treated as

1 a separate country. No designation shall be made under
2 this paragraph with respect to—

3	Australia	Liechtenstein
4	Austria	Luxembourg
5	Belgium	Monaco
6	Canada	Netherlands
7	Denmark	New Zealand
8	France	Norway
9	Germany (Federal	Union of South Africa
10	Republic)	San Marino
11	Hong Kong	Sweden
12	Italy	Switzerland
13	Japan	United Kingdom

14 **“SEC. 954. CONTROLLED FOREIGN CORPORATIONS.**

15 “(a) GENERAL RULE.—For purposes of this subpart,
16 the term ‘controlled foreign corporation’ means any foreign
17 corporation of which more than 50 percent of the total com-
18 bined voting power of all classes of stock entitled to vote is
19 owned, directly or indirectly (within the meaning of section
20 955 (b)), by United States persons on any day during the
21 taxable year of such foreign corporation.

22 “(b) SPECIAL RULE FOR INSURANCE.—For purposes
23 only of taking into account income described in section
24 952 (a) (1) (A) (relating to income derived from insurance
25 of United States risks), the term ‘controlled foreign corpora-

tion' includes not only a foreign corporation as defined by subsection (a) but also one of which more than 25 percent of the total combined voting power of all classes of stock is owned, directly or indirectly (within the meaning of section 955 (b)), by United States persons on any day during the taxable year of such corporation, if the gross amount of premiums or other consideration in respect of reinsurance or the issuing of insurance or annuity contracts in connection with property in, or residents of, the United States, exceeds 75 percent of the gross amount of all premiums or other consideration in respect of all risks.

“(c) SPECIAL RULE FOR CERTAIN LESS DEVELOPED COUNTRIES.—In the case of any foreign corporation to which section 953 (b) (2) (C) applies, the maximum percentage of ownership permitted under the laws of a less developed country shall be considered, in lieu of the more than 50 percent requirement in subsection (a), the percentage required under subsection (a) in order for the corporation to be classified as a controlled foreign corporation.

“SEC. 955. RULES FOR DETERMINING STOCK OWNERSHIP.

“(a) FOR PURPOSES OF SECTION 951 (a).—

“(1) GENERAL RULE.—For purposes of section 951 (a), stock owned means—

“(A) stock owned directly, and

1 “(B) stock owned with the application of para-
2 graph (2).

3 “(2) STOCK OWNERSHIP THROUGH FOREIGN EN-
4 TITIES.—For purposes of subparagraph (B) of para-
5 graph (1), stock owned, directly or indirectly, by or
6 for a foreign corporation, foreign partnership, or foreign
7 trust or foreign estate (within the meaning of section
8 7701 (a) (31)) shall be considered as being owned pro-
9 portionately by its shareholders, partners, or benefici-
10 aries. Stock considered to be owned by a person by reason
11 of the application of the preceding sentence shall, for
12 purposes of applying such sentence, be treated as actually
13 owned by such person.

14 “(3) SPECIAL RULE FOR MUTUAL INSURANCE
15 COMPANIES.—For purposes of applying paragraph (1)
16 in the case of a foreign mutual insurance company, the
17 term ‘stock’ shall include any certificate entitling the
18 holder to voting power in the corporation.

19 “(b) OTHER PROVISIONS.—For purposes of sections 951
20 (b), 952 (a) (1) (C), and 954, section 318 (a) (relating to
21 constructive ownership of stock) shall apply to the extent
22 that the effect is to subject a United States person to the
23 requirement of section 951 (a), to treat 5 or fewer United
24 States persons as owning more than 50 percent of all classes
25 of stock entitled to vote of a controlled foreign corporation,

1 or to make a foreign corporation a controlled foreign cor-
2 poration under section 954, except—

3 “(1) In applying paragraph (1) (A) of section
4 318 (a), stock owned by a nonresident alien individual
5 (other than a foreign trust or foreign estate) shall not
6 be considered as owned by a citizen or by a resident
7 alien individual.

8 “(2) In applying the first sentence of subpara-
9 graphs (A) and (B), and in applying clause (i) of
10 subparagraph (C), of section 318 (a) (2)—

11 “(A) if a partnership, estate, trust, or corpora-
12 tion owns, directly or indirectly, more than 50 per-
13 cent of the total combined voting power of all classes
14 of stock entitled to vote of a corporation, it shall be
15 considered as owning all the stock entitled to vote,
16 and

17 “(B) if a partnership, estate, trust, or corpora-
18 tion owns, directly or indirectly, more than 50 per-
19 cent of the total value of shares of all classes of stock
20 of a corporation, it shall be considered as owning
21 the total value of all of the outstanding stock of such
22 corporation. The application of this subparagraph
23 shall not have the effect of increasing voting power
24 of a partner, beneficiary, or shareholder, for pur-
25 poses of subparagraph (A).

1 “(3) Stock owned by a partnership, estate, trust,
 2 or corporation, by reason of the application of the second
 3 sentence of subparagraphs (A) and (B), and the appli-
 4 cation of clause (ii) of subparagraph (C), of section
 5 318 (a) (2), shall not be considered as owned by such
 6 partnership, estate, trust, or corporation, for the purposes
 7 of applying the first sentence of subparagraphs (A) and
 8 (B), and in applying clause (i) of subparagraph (C),
 9 of section 318 (a) (2).

10 “(4) In applying clause (i) of subparagraph (C)
 11 of section 318 (a) (2), the 50-percent limitation con-
 12 tained in subparagraph (C) shall not apply.

13 **“SEC. 956. EXCLUSION FROM GROSS INCOME OF PREVI-**
 14 **OUSLY TAXED EARNINGS AND PROFITS.**

15 “(a) EXCLUSION FROM GROSS INCOME OF UNITED
 16 STATES PERSONS.—For purposes of this chapter, the earn-
 17 ings and profits for a taxable year of a foreign corporation
 18 attributable to amounts which are, or have been, included in
 19 the gross income of a United States person under section
 20 951 (a) shall not, when—

21 “(1) such amounts are distributed to, or

22 “(2) such amounts would, but for this subsection,
 23 be included under section 951 (a) (1) (B) in the gross
 24 income of,

25 such person (or any other United States person who acquires

1 from any person any portion of the interest of such United
2 States person in such foreign corporation, but only to the ex-
3 tent of such portion, and subject to such proof of the identity
4 of such interest as the Secretary or his delegate may by regu-
5 lations prescribe) directly, or indirectly through a chain of
6 ownership described under section 955 (a) , be again included
7 in the gross income of such United States person (or of such
8 other United States person) .

9 “ (b) EXCLUSION FROM GROSS INCOME OF CERTAIN
10 FOREIGN SUBSIDIARIES.—For purposes of section 951 (a) ,
11 the earnings and profits for a taxable year of a controlled
12 foreign corporation attributable to amounts which are, or
13 have been, included in the gross income of a United States
14 person under section 951 (a) , shall not, when distributed
15 through a chain of ownership described under section 955
16 (a) , be also included in the gross income of another con-
17 trolled foreign corporation in such chain for purposes of the
18 application of section 951 (a) to such other controlled foreign
19 corporation with respect to such United States person (or to
20 any other United States person who acquires from any per-
21 son any portion of the interest of such United States person
22 in the controlled foreign corporation, but only to the extent of
23 such portion, and subject to such proof of identity of such
24 interest as the Secretary or his delegate may prescribe by
25 regulations) .

1 “(c) ALLOCATION OF DISTRIBUTIONS.—For purposes
2 of subsections (a) and (b), section 316(a) shall be ap-
3 plied by applying paragraph (2) thereof, and then para-
4 graph (1) thereof—

5 “(1) first to earnings and profits attributable to
6 amounts included in gross income under section 951
7 (a) (1) (B) (or which would have been included except
8 for section 956 (a) (2)),

9 “(2) then to earnings and profits attributable to
10 amounts included in gross income under section 951 (a)
11 (1) (A) (but reduced by amounts not included under
12 section 951 (a) (1) (B) because of the exclusion in sec-
13 tion 956 (a) (2)), and

14 “(3) then to other earnings and profits.

15 “(d) DISTRIBUTIONS EXCLUDED FROM GROSS IN-
16 COME NOT TO BE TREATED AS DIVIDENDS.—Except as pro-
17 vided in section 957 (a) (3), any distribution excluded from
18 gross income under subsection (a) shall be treated, for pur-
19 poses of this chapter, as a distribution which is not a
20 dividend.

21 “SEC. 957. SPECIAL RULES FOR FOREIGN TAX CREDIT.

22 “(a) TAXES PAID BY A FOREIGN CORPORATION.—

23 “(1) GENERAL RULE.—For purposes of subpart A
24 of this part, if there is included, under section 951 (a),

1 in the gross income of a domestic corporation any
2 amount attributable to earnings and profits—

3 “(A) of a foreign corporation at least 10 per-
4 cent of the voting stock of which is directly owned
5 by such domestic corporation, or

6 “(B) of a foreign corporation at least 50 per-
7 cent of the voting stock of which is directly owned
8 by a foreign corporation at least 10 percent of the
9 voting stock of which is in turn directly owned by
10 such domestic corporation,

11 then, under regulations prescribed by the Secretary or
12 his delegate, such domestic corporation shall be deemed
13 to have paid the same proportion of the total income,
14 war profits, and excess profits taxes paid (or deemed
15 paid, if, paragraph (4) applies) to a foreign country
16 or possession of the United States for the taxable year
17 which the amount of earnings and profits of such foreign
18 corporation so included in gross income of the domestic
19 corporation bears to the entire amount of the total earn-
20 ings and profits of such foreign corporation for such
21 taxable year.

22 “(2) TAXES PREVIOUSLY DEEMED PAID BY DO-
23 MESTIC CORPORATION.—If a domestic corporation re-

1 ceives a distribution from a foreign corporation, any
2 portion of which is excluded from gross income under
3 section 956, the income, war profits, and excess profits
4 taxes paid or deemed paid by such foreign corporation
5 to any foreign country or to any possession of the United
6 States in connection with the earnings and profits of
7 such foreign corporation from which such distribution
8 is made shall not be taken into account for purposes
9 of section 902, to the extent such taxes were deemed
10 paid by such domestic corporation under paragraph (1)
11 for any prior taxable year.

12 “(3) TAXES PAID BY FOREIGN CORPORATION AND
13 NOT PREVIOUSLY DEEMED PAID BY DOMESTIC CORPORA-
14 TION.—Any portion of a distribution from a foreign cor-
15 poration received by a domestic corporation which is
16 excluded from gross income under section 956 (a) shall
17 be treated by the domestic corporation as a dividend,
18 solely for purposes of taking into account under section 902
19 any income, war profits, or excess profits taxes paid to
20 any foreign country or to any possession of the United
21 States, on or with respect to the accumulated profits of
22 such foreign corporation from which such distribution is
23 made, which were not deemed paid by the domestic
24 corporation under paragraph (1) for any prior taxable
25 year.

1 “(4) TAXES PAID BY A FOREIGN SUBSIDIARY.—If
2 subparagraph (A) of paragraph (1) applies with re-
3 spect to an amount included in gross income under sec-
4 tion 951 (a) for a taxable year, then such amount shall
5 be considered a dividend for purpose of the application
6 of section 902 (b).

7 “(5) INCLUSION IN GROSS INCOME.—

**“For inclusion in gross income of amount equal to
 taxes deemed paid under paragraph (1), see section 78.**

8 “(b) SPECIAL RULES FOR FOREIGN TAX CREDIT IN
9 YEAR OF RECEIPT OF PREVIOUSLY TAXED EARNINGS AND
10 PROFITS.—

11 “(1) INCREASE IN SECTION 904 LIMITATION.—In
12 the case of any taxpayer who—

13 “(A) either (i) chose to have the benefits of
14 subpart A of this part for a taxable year in which
15 he was required under section 951 (a) to include in
16 his gross income an amount in respect of a con-
17 trolled foreign corporation, or (ii) did not pay or
18 accrue for such taxable year any income, war profits,
19 or excess profits taxes to any foreign country or to
20 any possession of the United States, and

21 “(B) chooses to have the benefits of subpart
22 A of this part for the taxable year in which he re-
23 ceives a distribution or amount which is excluded

1 from gross income under section 956 (a) and which
2 is attributable to earnings and profits of the con-
3 trolled foreign corporation which was included in
4 his gross income for the taxable year referred to in
5 subparagraph (A), and

6 “(C) for the taxable year in which such dis-
7 tribution or amount is received, pays, or is deemed
8 to have paid, or accrues income, war profits, or ex-
9 cess profits taxes to a foreign country or to any
10 possession of the United States with respect to such
11 distribution or amount,

12 the applicable limitation under section 904 for the tax-
13 able year in which such distribution or amount is re-
14 ceived shall be increased as provided in paragraph (2),
15 but such increase shall not exceed the amount of such
16 taxes paid, or deemed paid, or accrued with respect
17 to such distribution or amount.

18 “(2) AMOUNT OF INCREASE.—The amount of in-
19 crease of the applicable limitation under section 904 (a)
20 for the taxable year in which the distribution or amount
21 referred to in paragraph (1) (B) is received shall be
22 an amount equal to—

23 “(A) the amount by which the applicable lim-
24 itation under section 904 (a) for the taxable year
25 referred to in paragraph (1) (A) was increased by

1 reason of the inclusion in gross income under section
2 951 (a) of the amount in respect of the controlled
3 foreign corporation, reduced by

4 “(B) the amount of any income, war profits,
5 and excess profits taxes paid, or deemed paid, or
6 accrued to any foreign country or possession of the
7 United States which were allowable as a credit
8 under section 901 for the taxable year referred to in
9 paragraph (1) (A) and which would not have been
10 allowable but for the inclusion in gross income of the
11 amount described in subparagraph (A).

12 “(3) CASES IN WHICH TAXES NOT TO BE AL-
13 LOWED AS DEDUCTION.—In the case of any taxpayer
14 who—

15 “(A) chose to have the benefits of subpart A
16 of this part for a taxable year in which he was re-
17 quired under section 951 (a) to include in his gross
18 income an amount in respect of a controlled foreign
19 corporation, and

20 “(B) does not choose to have the benefits of
21 subpart A of this part for the taxable year in which
22 he receives a distribution or amount which is ex-
23 cluded from gross income under section 956 (a) and
24 which is attributable to earnings and profits of the
25 controlled foreign corporation which was included

1 in his gross income for the taxable year referred to
2 in subparagraph (A),
3 no deduction shall be allowed under section 164 for the
4 taxable year in which such distribution or amount is
5 received for any income, war profits, or excess profits
6 taxes paid or accrued to any foreign country or to any
7 possession of the United States on or with respect to
8 such distribution or amount.

9 “(4) INSUFFICIENT TAXABLE INCOME.—If an in-
10 crease in the limitation under this subsection exceeds the
11 tax imposed by this chapter for such year, the amount
12 of such excess shall be deemed an overpayment of tax
13 for such year.

14 **“SEC. 958. ADJUSTMENTS TO BASIS OF STOCK IN CON-**
15 **TROLLED FOREIGN CORPORATION AND OF**
16 **OTHER PROPERTY.**

17 “(a) INCREASE IN BASIS.—Under regulations pre-
18 scribed by the Secretary or his delegate, the basis of a United
19 States person’s stock in a controlled foreign corporation, and
20 the basis of property of a United States person by reason of
21 which he is considered under section 955 (a) (2) as owning
22 stock of a controlled foreign corporation, shall be increased
23 by the amount required to be included in his gross income
24 under section 951 (a) with respect to such stock or with
25 respect to such property, as the case may be, but only to the

1 extent to which such amount was included in the gross
2 income of such person.

3 “(b) REDUCTION IN BASIS.—

4 “(1) IN GENERAL.—Under regulations prescribed
5 by the Secretary or his delegate, the adjusted basis of
6 stock or other property with respect to which a United
7 States person receives an amount which is excluded from
8 gross income under section 956(a) shall be reduced by
9 the amount so excluded.

10 “(2) AMOUNT IN EXCESS OF BASIS.—To the ex-
11 tent that an amount excluded from gross income under
12 section 956(a) exceeds the adjusted basis of the stock
13 or other property with respect to which it is received,
14 the amount shall be treated as gain from the sale or
15 exchange of property.”

16 (b) TECHNICAL AND CLERICAL AMENDMENTS.—

17 (1) Section 551(b) (relating to foreign personal
18 holding company income included in gross income of
19 United States shareholders) is amended by adding at
20 the end thereof the following new sentence: “The amount
21 included in the gross income of any United States share-
22 holder for any taxable year under the preceding sen-
23 tence shall be reduced by such shareholder’s proportion-
24 ate share of the undistributed personal holding company
25 income which is included in his gross income under

1 section 951 (a) (1) (A) (relating to amounts included
2 in gross income of United States persons) for such tax-
3 able year as his pro rata share of the subpart F income
4 of the company.”

5 (2) Section 901 (relating to foreign tax credit) is
6 amended by striking out “section 902” and inserting
7 in lieu thereof “sections 902 and 957”.

8 (3) Section 902 (e) is amended to read as follows:

9 “(e) CROSS REFERENCES.—

“(1) For application of subsections (a) and (b) with respect to taxes deemed paid in a prior taxable year by a United States person with respect to a controlled foreign corporation, see section 957.

“(2) For reduction of credit with respect to dividends paid out of accumulated profits for years for which certain information is not furnished, see section 6038.”

10 (4) Section 904 (f) is amended to read as follows:

11 “(f) CROSS REFERENCES.—

“(1) For increase of applicable limitation under subsection (a) for taxes paid with respect to amounts received which were included in the gross income of the taxpayer for a prior taxable year as a United States person with respect to a controlled foreign corporation, see section 957(b).

“(2) For special rule relating to the application of the credit provided by section 901 in the case of affiliated groups which include Western Hemisphere trade corporations for years in which the limitation provided by subsection (a)(2) applies, see section 1503(d).”

12 (5) The table of subparts for part III of subchapter
13 N of chapter 1 is amended by adding at the end thereof
14 the following:

“Subpart F. Controlled foreign corporations.”

1 (6) Section 1016(a) (relating to adjustments to
2 basis) is amended—

3 (A) by striking out the period at the end of
4 paragraph (18) and inserting in lieu thereof
5 a semicolon; and

6 (B) by adding after paragraph (18) the fol-
7 lowing new paragraph:

8 “(19) to the extent provided in section 958 in
9 the case of stock in controlled foreign corporations (or
10 foreign corporations which were controlled foreign cor-
11 porations) and of property by reason of which a per-
12 son is considered as owning such stock.”

13 (c) **EFFECTIVE DATE.**—The amendments made by this
14 section shall apply with respect to taxable years of foreign
15 corporations beginning after December 31, 1962, and to
16 taxable years of United States persons within which or
17 with which such taxable years of such foreign corporations
18 end.

19 **SEC. 14. GAIN FROM DISPOSITIONS OF CERTAIN DEPRE-**
20 **CIABLE PROPERTY.**

21 (a) **IN GENERAL.**—

22 (1) Part IV of subchapter P of chapter 1 (relating
23 to special rules for determining capital gains and losses)

1 is amended by adding at the end thereof the following
2 new section:

3 **"SEC. 1245. GAIN FROM DISPOSITIONS OF CERTAIN DE-**
4 **PRECIABLE PROPERTY.**

5 **"(a) GENERAL RULE.—**

6 **"(1) ORDINARY INCOME.—**Except as otherwise
7 provided in this section, if section 1245 property is dis-
8 posed of after the date of the enactment of the Revenue
9 Act of 1962, the amount by which the lower of—

10 **"(A)** the recomputed basis of the property, or

11 **"(B) (i)** in the case of a sale, exchange, or
12 involuntary conversion, the amount realized, or

13 **"(ii)** in the case of any other disposition, the
14 fair market value of such property,

15 exceeds the adjusted basis of such property shall be
16 treated as gain from the sale or exchange of property
17 which is neither a capital asset nor property described in
18 section 1231. Such gain shall be recognized notwith-
19 standing any other provision of this subtitle.

20 **"(2) RECOMPUTED BASIS.—**For purposes of this
21 section, the term 'recomputed basis' means, with respect
22 to any property, its adjusted basis recomputed by adding
23 thereto all adjustments, for taxable years beginning after
24 December 31, 1961, reflected in such adjusted basis on
25 account of deductions (whether in respect of the same

1 or other property) allowed or allowable to the taxpayer
 2 or to any other person for depreciation, or for amortiza-
 3 tion under section 168. For purposes of the preceding
 4 sentence, if the taxpayer can establish by adequate
 5 records or other sufficient evidence that the amount
 6 allowed for depreciation, or for amortization under sec-
 7 tion 168, for any taxable year was less than the amount
 8 allowable, the amount added for such taxable year shall
 9 be the amount allowed.

10 “(3) SECTION 1245 PROPERTY.—For purposes
 11 of this section, the term ‘section 1245 property’ means
 12 any property (other than livestock) which is or has
 13 been property of a character subject to the allowance
 14 for depreciation provided in section 167 and is either—

15 “(A) personal property, or

16 “(B) other property (not including a building
 17 or its structural components) but only if such other
 18 property is tangible and has an adjusted basis in
 19 which there are reflected adjustments described in
 20 paragraph (2) for a period in which such prop-
 21 erty (or other property) —

22 “(i) was used as an integral part of manu-
 23 facturing, production, or extraction or of fur-
 24 nishing transportation, communications, electri-

1 cal energy, gas, water, or sewage disposal serv-
2 ices, or

3 “(ii) constituted research or storage facili-
4 ties used in connection with any of the activi-
5 ties referred to in clause (i).

6 “(b) EXCEPTIONS AND LIMITATIONS.—

7 “(1) GIFTS.—Subsection (a) shall not apply to a
8 disposition by gift.

9 “(2) TRANSFERS AT DEATH.—Except as provided
10 in section 691 (relating to income in respect of a de-
11 cedent), subsection (a) shall not apply to a transfer at
12 death.

13 “(3) CERTAIN TAX-FREE TRANSACTIONS.—If the
14 basis of property in the hands of a transferee is deter-
15 mined by reference to its basis in the hands of the trans-
16 feror by reason of the application of section 332, 351,
17 361, 371 (a), 374 (a), 721, or 731, then the amount of
18 gain taken into account by the transferor under subsec-
19 tion (a) (1) shall not exceed the amount of gain recog-
20 nized to the transferor on the transfer of such property
21 (determined without regard to this section). This para-
22 graph shall not apply to a disposition to an organization
23 (other than a cooperative described in section 521)
24 which is exempt from the tax imposed by this chapter.

25 “(4) LIKE KIND EXCHANGES; INVOLUNTARY CON-

1 VERSIONS, ETC.—If property is disposed of and gain
2 (determined without regard to this section) is not rec-
3 ognized in whole or in part under section 1031 or 1033,
4 then the amount of gain taken into account by the trans-
5 feror under subsection (a) (1) shall not exceed the
6 sum of—

7 “(A) the amount of gain recognized on such
8 disposition (determined without regard to this sec-
9 tion), plus

10 “(B) the fair market value of property acquired
11 which is not section 1245 property and which is not
12 taken into account under subparagraph (A).

13 “(5) SECTION 1071 AND 1081 TRANSACTIONS.—
14 Under regulations prescribed by the Secretary or his
15 delegate, rules consistent with paragraphs (3) and (4)
16 of this subsection shall apply in the case of transactions
17 described in section 1071 (relating to gain from sale
18 or exchange to effectuate policies of FCC) or section
19 1081 (relating to exchanges in obedience to SEC
20 orders).

21 “(6) PROPERTY DISTRIBUTED BY A PARTNERSHIP
22 TO A PARTNER.—

23 “(A) IN GENERAL.—For purposes of this sec-
24 tion, the basis of section 1245 property distributed
25 by a partnership to a partner shall be deemed to

1 be determined by reference to the adjusted basis of
2 such property to the partnership.

3 “(B) ADJUSTMENTS ADDED BACK.—In the
4 case of any property described in subparagraph
5 (A), for purposes of computing the recomputed
6 basis of such property the amount of the adjustments
7 added back for periods before the distribution by
8 the partnership shall be—

9 “(i) the amount of the gain to which sub-
10 section (a) would have applied if such property
11 had been sold by the partnership immediately
12 before the distribution at its fair market value
13 at such time, reduced by

14 “(ii) the amount of such gain to which
15 section 751 (b) applied.

16 “(c) ADJUSTMENTS TO BASIS.—The Secretary or his
17 delegate shall prescribe such regulations as he may deem
18 necessary to provide for adjustments to the basis of property
19 to reflect gain recognized under subsection (a).

20 “(d) APPLICATION OF SECTION.—This section shall
21 apply notwithstanding any other provision of this subtitle.”

22 (2) The table of sections for such part IV is
23 amended by adding at the end thereof the following:

“Sec. 1245. Gain from dispositions of certain depreciable
property.”

1 (b) CHANGE IN METHOD OF DEPRECIATION.—Sub-
2 section (e) of section 167 (relating to depreciation) is
3 amended to read as follows:

4 “(e) CHANGE IN METHOD.—

5 “(1) CHANGE FROM DECLINING BALANCE
6 METHOD.—In the absence of an agreement under sub-
7 section (d) containing a provision to the contrary, a
8 taxpayer may at any time elect in accordance with regu-
9 lations prescribed by the Secretary or his delegate to
10 change from the method of depreciation described in sub-
11 section (b) (2) to the method described in subsection
12 (b) (1).

13 “(2) CHANGE WITH RESPECT TO SECTION 1245
14 PROPERTY.—A taxpayer may, within such period after
15 the date of the enactment of the Revenue Act of 1962
16 and in such manner as the Secretary or his delegate
17 shall by regulations prescribe, elect to change his method
18 of depreciation in respect of section 1245 property (as
19 defined in section 1245 (a) (3)) from any declining
20 balance or sum of the years-digits method to the straight
21 line method. An election may be made under this
22 paragraph notwithstanding any provision to the con-
23 trary in an agreement under subsection (d).”

1 (c) SALVAGE VALUE OF PERSONAL PROPERTY.—

2 (1) AMOUNT TAKEN INTO ACCOUNT.—Section
3 167 (relating to depreciation) is amended by redesignat-
4 ing subsections (f), (g), and (h) as (g), (h), and
5 (i), respectively, and by inserting after subsection (e)
6 the following new subsection:

7 “(f) SALVAGE VALUE.—

8 “(1) GENERAL RULE.—Under regulations pre-
9 scribed by the Secretary or his delegate, a taxpayer may,
10 for purposes of computing the allowance under sub-
11 section (a) with respect to personal property, reduce
12 the amount taken into account as salvage value by an
13 amount which does not exceed 10 percent of the basis
14 of such property (as determined under subsection (g)
15 as of the time as of which such salvage value is required
16 to be determined).

17 “(2) PERSONAL PROPERTY DEFINED.—For pur-
18 poses of this subsection, the term ‘personal property’
19 means depreciable personal property (other than live-
20 stock) with a useful life of 3 years or more acquired after
21 the date of the enactment of the Revenue Act of 1962.”

22 (2) CONFORMING AMENDMENTS.—

23 (A) Sections 179(d)(5) and 642(e) are
24 each amended by striking out “167(g)” and in-
25 serting in lieu thereof “167(h)”.

(B) Section 179 (d) (8) is amended by striking out “167 (f)” and inserting in lieu thereof “167 (g)”.

(d) SPECIAL RULE FOR CHARITABLE CONTRIBUTIONS OF SECTION 1245 PROPERTY.—Section 170 (relating to charitable, etc., contributions and gifts) is amended by redesignating subsections (e) and (f) as (f) and (g), respectively, and by inserting after subsection (d) the following new subsection:

“(e) SPECIAL RULE FOR CHARITABLE CONTRIBUTIONS OF SECTION 1245 PROPERTY.—The amount of any charitable contribution taken into account under this section shall be reduced by the amount which would have been treated as gain to which section 1245 (a) applies if the property contributed had been sold at its fair market value (determined at the time of such contribution).”

(e) TECHNICAL AMENDMENTS.—

(1) SPECIAL RULE FOR PARTNERSHIPS.—Section 751 (c) (relating to definition of “unrealized receivables” for purposes of subchapter K) is amended by adding after paragraph (2) the following:

“For purposes of this section and sections 731, 736, and 741, such term also includes section 1245 property (as defined in section 1245 (a) (3)), but only to the extent of the

1 amount which would be treated as gain to which section
2 1245 (a) would apply if (at the time of the transaction de-
3 scribed in this section or section 731, 736, or 741, as the
4 case may be) such property had been sold by the partner-
5 ship at its fair market value.”

6 (2) CORPORATE DISTRIBUTION OF PROPERTY.—
7 Subsections (b) and (d) of section 301 (relating to
8 amount distributed) are each amended by striking out
9 “subsection (b) or (c) of section 311” and inserting in
10 lieu thereof “subsection (b) or (c) of section 311 or
11 under section 1245 (a) ”.

12 (3) EFFECT ON EARNINGS AND PROFITS.—Section
13 312 (c) (3) (relating to adjustments of earnings and
14 profits) is amended by striking out “subsection (b)
15 or (c) of section 311” and inserting in lieu thereof
16 “subsection (b) or (c) of section 311 or under sec-
17 tion 1245 (a) ”.

18 (4) COLLAPSIBLE CORPORATIONS.—Section 341
19 (e) (relating to collapsible corporations) is amended
20 by inserting after paragraph (11) the following new
21 paragraph:

22 “(12) NONAPPLICATION OF SECTION 1245(a).—
23 For purposes of this subsection, the determination of
24 whether gain from the sale or exchange of property
25 would under any provision of this chapter be considered

1 as gain from the sale or exchange of property which is
2 neither a capital asset nor property described in section
3 1231 (b) shall be made without regard to the applica-
4 tion of section 1245 (a).”

5 (5) INSTALLMENT OBLIGATIONS IN CERTAIN
6 LIQUIDATIONS.—

7 (A) Section 453 (d) (4) (A) (relating to
8 distribution of installment obligations in section 332
9 liquidations) is amended by adding at the end there-
10 of the following new sentence: “If the basis of the
11 property of the liquidating corporation in the hands
12 of the distributee is determined under section 334
13 (b) (2) then the preceding sentence shall not apply
14 to the extent that under paragraph (1) gain to the
15 distributing corporation would be considered as gain
16 to which section 1245 (a) applies.”

17 (B) Section 453 (d) (4) (B) (relating to dis-
18 tribution of installment obligations in liquidations
19 to which section 337 applies) is amended by adding
20 at the end thereof the following new sentence: “The
21 preceding sentence shall not apply to the extent that
22 under paragraph (1) gain to the distributing cor-
23 poration would be considered as gain to which sec-
24 tion 1245 (a) applies.”

25 (f) EFFECTIVE DATE.—The amendments made by this

1 section shall apply to taxable years beginning after December
2 31, 1961, and ending after the date of the enactment of this
3 Act.

4 **SEC. 15. FOREIGN INVESTMENT COMPANIES.**

5 (a) TREATMENT OF SALE OF STOCK OF FOREIGN
6 INVESTMENT COMPANIES.—

7 (1) IN GENERAL.—Part IV of subchapter P of
8 chapter 1 (relating to special rules for determining
9 capital gains and losses) is amended by adding after
10 section 1245 (as added by section 14 of this Act) the
11 following new sections:

12 **“SEC. 1246. GAIN ON FOREIGN INVESTMENT COMPANY**
13 **STOCK.**

14 **“(a) TREATMENT OF GAIN AS ORDINARY INCOME.—**

15 **“(1) GENERAL RULE.—**In the case of a sale or
16 exchange after December 31, 1962, of stock in a foreign
17 corporation which was a foreign investment company
18 (as defined in subsection (b)) at any time during the
19 period during which the taxpayer held such stock, any
20 gain shall be treated as gain from the sale or exchange
21 of property which is not a capital asset, to the extent
22 of the taxpayer's ratable share of the earnings and
23 profits of such corporation accumulated for taxable years
24 beginning after December 31, 1962.

25 **“(2) RATABLE SHARE.—**For purposes of this sec-

tion, the taxpayer's **ratable** share shall be determined under regulations prescribed by the Secretary or his delegate, but shall include only his ratable share of the accumulated earnings and profits of such corporation—

“(A) for the period during which the taxpayer held such stock, but

“(B) excluding such earnings and profits which were taxed to such taxpayer under section 951 or under section 551.

“(3) **TAXPAYER TO ESTABLISH EARNINGS AND PROFITS.**—Unless the taxpayer establishes the amount of the accumulated earnings and profits of the foreign investment company and the ratable share thereof for the period during which the taxpayer held such stock, all the gain from the sale or exchange of stock in such company shall be considered as gain from the sale or exchange of property which is not a capital asset.

“(4) **HOLDING PERIOD OF STOCK MUST BE MORE THAN 6 MONTHS.**—This section shall not apply with respect to the sale or exchange of stock where the holding period of such stock as of the date of such sale or exchange is 6 months or less.

“(b) **DEFINITION OF FOREIGN INVESTMENT COMPANY.**—For purposes of this section, the term ‘foreign investment company’ means any foreign corporation—

1 “(1) registered under the Investment Company
2 Act of 1940, as amended (15 U.S.C. 80a-1 to 80b-2),
3 either as a management company or as a unit invest-
4 ment trust, or

5 “(2) engaged (or holding itself out as being
6 engaged) primarily in the business of investing, rein-
7 vesting, or trading in securities (within the meaning of
8 section 3 (a) (1) of such Act) at a time when more
9 than 50 percent of the total combined voting power of
10 all classes of stock entitled to vote, or of the total value
11 of shares of all classes of stock, was held, directly or
12 indirectly (within the meaning of section 955 (a)), by
13 United States persons (as defined in section 7701
14 (a) (30)).

15 “(c) STOCK HAVING TRANSFERRED OR SUBSTITUTED
16 BASIS.—To the extent provided in regulations prescribed
17 by the Secretary or his delegate, stock in a foreign corpora-
18 tion, the basis of which (in the hands of the taxpayer selling
19 or exchanging such stock) is determined by reference to the
20 basis (in the hands of such taxpayer or any other person)
21 of stock in a foreign investment company, shall be treated
22 as stock of a foreign investment company and held by the
23 taxpayer throughout the holding period for such stock (deter-
24 mined under section 1223).

1 “(d) RULES RELATING TO ENTITIES HOLDING FOR-
2 EIGN INVESTMENT COMPANY STOCK.—To the extent pro-
3 vided in regulations prescribed by the Secretary or his
4 delegate—

5 “(1) trust certificates of a trust to which section
6 677 (relating to income for benefit of grantor) applies,
7 and

8 “(2) stock of a domestic corporation,
9 shall be treated as stock of a foreign investment company and
10 held by the taxpayer throughout the holding period for such
11 certificates or stock (determined under section 1223) in the
12 same proportion that the investment in stock in a foreign
13 investment company by the trust or domestic corporation
14 bears to the total assets of such trust or corporation.

15 “(e) RULES RELATING TO STOCK ACQUIRED FROM A
16 DECEDENT.—

17 “(1) BASIS.—In the case of stock of a foreign
18 investment company acquired by bequest, devise, or
19 inheritance (or by the decedent’s estate) from a dece-
20 dent dying after December 31, 1962, the basis deter-
21 mined under section 1014 shall be reduced (but not
22 below the adjusted basis of such stock in the hands of
23 the decedent immediately before his death) by the
24 amount of the decedent’s ratable share of the accumu-

1 lated earnings and profits of such company. Any
2 stock so acquired shall be treated as stock described in
3 subsection (c).

4 “(2) DEDUCTION FOR ESTATE TAX.—If stock to
5 which subsection (a) applies is acquired from a dece-
6 dent, the taxpayer shall, under regulations prescribed
7 by the Secretary or his delegate, be allowed (for the
8 taxable year of the sale or exchange) a deduction from
9 gross income equal to that portion of the decedent’s
10 estate tax deemed paid which is attributable to the excess
11 of (A) the value at which such stock was taken into
12 account for purposes of determining the value of the
13 decedent’s gross estate, over (B) the value at which
14 it would have been so taken into account if such value
15 had been reduced by the amount described in para-
16 graph (1).

17 “(f) . INFORMATION WITH RESPECT TO CERTAIN
18 FOREIGN INVESTMENT.—Every United States person who,
19 on the last day of the taxable year of a foreign investment
20 company beginning after December 31, 1962, owns 5 per-
21 cent or more in value of the stock of such company shall
22 furnish with respect to such company such information as the
23 Secretary or his delegate shall by regulations prescribe.

24 “(g) CROSS REFERENCE.—

“For special rules relating to the earnings and profits
of foreign investment companies, see section 312(1).

1 "SEC. 1247. ELECTION BY FOREIGN INVESTMENT COM-
2 PANIES TO DISTRIBUTE INCOME CUR-
3 RENTLY.

4 "(a) ELECTION BY FOREIGN INVESTMENT COM-
5 PANY.—

6 "(1) IN GENERAL.—If a foreign investment com-
7 pany which is described in section 1246 (b) (1) elects
8 (in the manner provided in regulations prescribed by
9 the Secretary or his delegate) on or before December
10 31, 1962, with respect to each taxable year beginning
11 after December 31, 1962, to—

12 "(A) distribute to its shareholders 90 percent
13 or more of what its taxable income would be if it
14 were a domestic corporation;

15 "(B) designate in a written notice mailed to
16 its shareholders at any time before the expiration
17 of 30 days after the close of its taxable year the
18 pro rata amount of the excess (determined as if such
19 corporation were a domestic corporation) of the net
20 long-term capital gains over the net short-term
21 capital losses; and the portion thereof which is being
22 distributed; and

23 "(C) provide such information as the Secre-
24 tary or his delegate deems necessary to carry out the
25 purposes of this section,

1 then section 1246 shall not apply with respect to the
2 qualified shareholders of such company during any
3 taxable year to which such election applies.

4 “(2) SPECIAL RULES.—

5 “(A) COMPUTATION OF TAXABLE INCOME.—

6 For purposes of paragraph (1) (A), the taxable
7 income of the company shall be computed without
8 regard to—

9 “(i) the excess of capital gains over losses
10 referred to in paragraph (1) (B),

11 “(ii) section 172 (relating to net operating
12 losses), and

13 “(iii) any deduction provided by part VIII
14 of subchapter B (other than the deduction pro-
15 vided by section 248, relating to organizational
16 expenditures).

17 “(B) DISTRIBUTIONS AFTER THE CLOSE OF
18 THE TAXABLE YEAR.—For purposes of paragraph
19 (1) (A), a distribution made after the close of the
20 taxable year and on or before the 15th day of the
21 third month of the next taxable year shall be treated
22 as distributed during the taxable year to the extent
23 elected by the company (in accordance with regu-
24 lations prescribed by the Secretary or his delegate)
25 on or before the 15th day of such third month.

1 “(C) CARRYOVER OF CAPITAL LOSSES FROM
2 NONELECTION YEARS DENIED.—In computing the
3 excess of capital gains over losses referred to in
4 paragraph (1) (B), section 1212 shall not apply
5 to losses incurred in or with respect to taxable years
6 before the first taxable year to which the election
7 applies.

8 “(b) YEARS TO WHICH ELECTION APPLIES.—The
9 election of any foreign investment company under this sec-
10 tion shall terminate as of the close of the taxable year pre-
11 ceding its first taxable year in which any of the following
12 occurs:

13 “(1) the company fails to comply with the provi-
14 sions of subparagraph (A), (B), or (C) of subsection
15 (a) (1), unless it is shown that such failure is due to
16 reasonable cause and not due to willful neglect,

17 “(2) the company is a foreign personal holding
18 company, or

19 “(3) the company is not a foreign investment com-
20 pany which is described in section 1246 (b) (1).

21 “(c) QUALIFIED SHAREHOLDERS.—For purposes of
22 this section—

23 “(1) IN GENERAL.—The term ‘qualified share-
24 holder’ means any shareholder who is a United States

1 person, other than a shareholder described in paragraph
2 (2).

3 “(2) CERTAIN UNITED STATES PERSONS EX-
4 CLUDED FROM DEFINITION.—A United States person
5 shall not be treated as a qualified shareholder for the
6 taxable year if for such taxable year (or for any prior
7 taxable year) he did not include, in computing his long-
8 term capital gains in his return for such taxable year,
9 the amount designated by such company pursuant to
10 subsection (a) (1) (B) as his share of the undistributed
11 capital gains of such company for its taxable year end-
12 ing within or with such taxable year of the taxpayer.
13 The preceding sentence shall not apply with respect
14 to any failure by the taxpayer to treat an amount as
15 provided therein if the taxpayer shows that such failure
16 was due to reasonable cause and not due to willful
17 neglect.

18 “(d) ADJUSTMENTS.—Under regulations prescribed
19 by the Secretary or his delegate, proper adjustment shall be
20 made—

21 “(1) in the earnings and profits of the electing
22 foreign investment company, and

23 “(2) the adjusted basis of stock of such company
24 held by qualified shareholders,

1 to reflect the inclusion in gross income by such shareholders
2 of undistributed capital gains.

3 “(e) LOSS ON SALE OR EXCHANGE OF CERTAIN STOCK
4 HELD LESS THAN 6 MONTHS.—If—

5 “(1) under this section, any qualified shareholder
6 treats any amount designated under subsection (a) (1)
7 (B) with respect to a share of stock as long-term capital
8 gain, and

9 “(2) such share is held by the taxpayer for less
10 than 6 months,

11 then any loss on the sale or exchange of such share shall,
12 to the extent of the amount described in paragraph (1),
13 be treated as loss from the sale or exchange of a capital
14 asset held for more than 6 months.”

15 (2) The table of sections for such part IV is
16 amended by adding at the end thereof the following:

“Sec. 1246. Gain on foreign investment company.

“Sec. 1247. Election by foreign investment companies to
distribute income currently.”

17 (b) CONFORMING AMENDMENTS.—

18 (1) EARNINGS AND PROFITS OF FOREIGN IN-
19 VESTMENT COMPANIES.—Section 312 (relating to
20 effect on earnings and profits) is amended by adding
21 after subsection (k) the following new subsection:

1 “(1) EARNINGS AND PROFITS OF FOREIGN INVEST-
2 MENT COMPANIES.—

3 “(1) ALLOCATION WITHIN AFFILIATED GROUP.—

4 In the case of a sale or exchange of stock in a foreign
5 investment company (as defined in section 1246 (b))
6 by a United States person (as defined in section 7701
7 (a) (30)) , if such company is a member of an affiliated
8 group, then the accumulated earnings and profits of all
9 members of such affiliated group shall be allocated, under
10 regulations prescribed by the Secretary or his delegate,
11 in such manner as is proper to carry out the purposes of
12 section 1246.

13 “(2) AFFILIATED GROUP DEFINED.—For purposes
14 of paragraphs (1) and (2) of this subsection, the term
15 ‘affiliated group’ has the meaning assigned to such term
16 by section 1504 (a) ; except that (A) ‘more than 50
17 percent’ shall be substituted for ‘80 percent or more’,
18 and (B) all corporations shall be treated as includible
19 corporations (without regard to the provisions of
20 section 1504 (b)) .

21 “(3) PARTIAL LIQUIDATIONS AND REDEMP-
22 TIONS.—

23 “(A) IN GENERAL.—If a foreign investment
24 company (as defined in section 1246) distributes
25 amounts in partial liquidation or in a redemption to

1 which section 302 (a) or 303 applies, the part of
2 such distribution which is properly chargeable to
3 earnings and profits shall be an amount which is
4 not in excess of the ratable share of the earnings
5 and profits of the company accumulated after
6 February 28, 1913, attributable to the stock so
7 redeemed.

8 “(B) EFFECTIVE DATE.—Subparagraph (A)
9 shall apply only with respect to distributions made
10 after December 31, 1962.”

11 (2) SALE OR EXCHANGE OF INTEREST IN PART-
12 NERSHIP.—Section 751 (d) (2) (relating to inventory
13 items which have appreciated substantially in value) is
14 amended by striking out “and” at the end of subpara-
15 graph (B), and by striking out subparagraph (C) and
16 inserting in lieu thereof the following new subparagraphs:

17 “(C) any other property of the partnership
18 which, if sold or exchanged by the partnership,
19 would result in a gain taxable under subsection (a)
20 of section 1246 (relating to gain on foreign invest-
21 ment company stock), and

22 “(D) any other property held by the partner-
23 ship which, if held by the selling or distributee part-
24 ner, would be considered property of the type
25 described in subparagraph (A), (B), or (C).”

1 (3) **HOLDING PERIOD OF PROPERTY.**—Section
2 1223 (relating to holding period of property) is amend-
3 ed by redesignating paragraph (10) as paragraph (11)
4 and inserting after paragraph (9) the following para-
5 graph:

6 “(10) In determining the period for which the
7 taxpayer has held trust certificates of a trust to which
8 subsection (d) of section 1246 applies, or the period
9 for which the taxpayer has held stock in a corporation
10 to which subsection (d) of section 1246 applies, there
11 shall be included the period for which the trust or cor-
12 poration (as the case may be) held the stock of foreign
13 investment companies.”

14 (c) **EFFECTIVE DATE.**—The amendments made by
15 this section shall apply with respect to taxable years begin-
16 ning after December 31, 1962.

17 **SEC. 16. GAIN FROM CERTAIN SALES OR EXCHANGES OF**
18 **STOCK IN CERTAIN FOREIGN CORPORATIONS.**

19 (a) **TREATMENT OF GAIN FROM THE REDEMPTION,**
20 **CANCELLATION, OR SALE OF STOCK IN CERTAIN FOREIGN**
21 **CORPORATIONS.**—Part IV of subchapter P of chapter 1
22 (relating to special rules for determining capital gains and
23 losses) is amended by adding after section 1247 (as added
24 by section 15 of this Act) the following new section:

1 "SEC. 1248. GAIN FROM CERTAIN SALES OR EXCHANGES
2 OF STOCK IN CERTAIN FOREIGN CORPORA-
3 TIONS.

4 "(a) REDEMPTIONS AND LIQUIDATIONS.—If a foreign
5 corporation redeems its stock in an exchange to which sec-
6 tion 302(a) applies, or if a foreign corporation cancels its
7 stock in a complete or partial liquidation in an exchange to
8 which section 331 applies, then the gain of a United States
9 person (as defined in section 7701(a)(30)) from the ex-
10 change of such stock shall be included in the gross income
11 of such person as a dividend, to the extent of such person's
12 proportionate share of the earnings and profits of the foreign
13 corporation accumulated after February 28, 1913.

14 "(b) SALES AND OTHER EXCHANGES.—If a United
15 States person (as defined in section 7701(a)(30)) sells or
16 exchanges stock in a foreign corporation, then the gain
17 recognized on the sale or exchange of such stock shall be
18 considered as gain from the sale or exchange of property
19 which is not a capital asset, to the extent of such person's
20 proportionate share of the earnings and profits of the foreign
21 corporation accumulated during the period the stock sold or
22 exchanged was held by such person.

1 “(c) LIMITATIONS.—

2 “(1) CONTROLLED FOREIGN CORPORATIONS.—

3 Subsections (a) and (b) shall apply only if the foreign
4 corporation the stock of which is sold or exchanged (A)
5 is a controlled foreign corporation (as defined in section
6 954) at the time of the sale or exchange, or (B) was
7 such a controlled foreign corporation at any time during
8 the 5-year period ending on the date of the sale or
9 exchange.

10 “(2) 10-PERCENT OWNERSHIP.—Subsections (a)
11 and (b) shall apply only to a United States person who
12 can be considered, by applying the rules of constructive
13 ownership of section 955(b), as being the owner,
14 directly or indirectly, of 10 percent or more of the total
15 combined voting power of all classes of stock entitled
16 to vote of the foreign corporation at the time of the sale
17 or exchange, or at any time during the 5-year period
18 ending on the date of the sale or exchange.

19 “(3) ELIMINATION FROM EARNINGS AND PROFITS
20 OF AMOUNTS INCLUDED IN GROSS INCOME UNDER
21 SECTION 951.—In determining the amount to be con-
22 sidered a dividend under subsection (a), or as gain from
23 the sale or exchange of property which is not a capital

1 asset under subsection (b), the United States person's
2 proportionate share of earnings and profits of the foreign
3 corporation shall be reduced by the amount previously
4 included in the gross income of such person under section
5 951, with respect to the stock sold or exchanged, but
6 only to the extent such amount did not result in an
7 exclusion from gross income under section 956.

8 “(4) REDEMPTIONS TO PAY DEATH TAXES.—Sub-
9 sections (a) and (b) shall not apply to distributions to
10 which section 303 (relating to distributions in re-
11 demption of stock to pay death taxes) applies.

12 “(5) ADDITIONAL CONSIDERATION IN CERTAIN
13 REORGANIZATIONS.—Subsection (b) shall not apply to
14 gain recognized on exchanges to which section 356 (re-
15 lating to receipt of additional consideration in certain
16 reorganizations) applies.

17 “(6) TREATMENT OF AMOUNTS WHICH ARE ORDI-
18 NARY INCOME, ETC., UNDER OTHER PROVISIONS.—Sub-
19 sections (a) and (b) shall not apply with respect to any
20 amount to the extent that such amount is, under any
21 other provision of this title, treated as—

22 “(A) a dividend,

1 “(B) gain from the sale of an asset which is
2 not a capital asset, or

3 “(C) gain from the sale of an asset held for not
4 more than 6 months.

5 “(d) TAXPAYER TO ESTABLISH EARNINGS AND
6 PROFITS.—Unless the taxpayer establishes the amount of
7 the earnings and profits of the foreign corporation to be taken
8 into account under subsections (a) and (b), all gain from
9 the sale or exchange shall be considered a dividend under
10 subsection (a), or as gain from the sale or exchange of
11 property which is not a capital asset under subsection (b),
12 whichever applies.”

13 (b) CLERICAL AMENDMENT.—The table of sections for
14 such part IV is amended by adding at the end thereof the
15 following:

“Sec. 1248. Gain from certain sales or exchanges of stock
in certain foreign corporations.”

16 (c) EFFECTIVE DATE.—The amendments made by this
17 section shall apply with respect to sales or exchanges oc-
18 ccurring after the date of the enactment of this Act.

1 **SEC. 17. TAX TREATMENT OF COOPERATIVES AND**
 2 **PATRONS.**

3 (a) **IN GENERAL.**—Chapter 1 (relating to normal
 4 taxes and surtaxes) is amended by adding at the end thereof
 5 the following new subchapter:

6 **“Subchapter T—Cooperatives and Their Patrons**

“Part I. Tax treatment of cooperatives.

“Part II. Tax treatment by patrons of patronage dividends.

“Part III. Definitions; special rules.

7 **“PART I—TAX TREATMENT OF COOPERATIVES**

“Sec. 1381. Organizations to which part applies.

“Sec. 1382. Taxable income of cooperatives.

“Sec. 1383. Computation of tax where cooperative redeems
 nonqualified written notices of allocation.

8 **“SEC. 1381. ORGANIZATIONS TO WHICH PART APPLIES.**

9 “(a) **IN GENERAL.**—This part shall apply to—

10 “(1) any organization exempt from tax under sec-
 11 tion 521 (relating to exemption of farmers’ cooperatives
 12 from tax), and

13 “(2) any corporation operating on a cooperative
 14 basis other than an organization—

15 “(A) which is exempt from tax under this
 16 chapter,

1 “(B) which is subject to the provisions of—

2 “(i) part II of subchapter H (relating
3 to mutual savings banks, etc.), or

4 “(ii) subchapter L (relating to insurance
5 companies), or

6 “(C) which is engaged in furnishing electric
7 energy, or providing telephone service, to persons
8 in rural areas.

9 “(b) TAX ON CERTAIN FARMERS’ COOPERATIVES.—

10 An organization described in subsection (a) (1) shall be
11 subject to the taxes imposed by section 11 or 1201.

12 **“SEC. 1382. TAXABLE INCOME OF COOPERATIVES.**

13 “(a) GROSS INCOME.—Except as provided in subsec-
14 tion (b), the gross income of any organization to which this
15 part applies shall be determined without any adjustment
16 (as a reduction in gross receipts, an increase in cost of goods
17 sold, or otherwise) by reason of any allocation or distribution
18 to a patron out of the net earnings of such organization.

19 “(b) PATRONAGE DIVIDENDS.—In determining the
20 taxable income of an organization to which this part applies,
21 there shall not be taken into account amounts paid during
22 the payment period for the taxable year—

23 “(1) as patronage dividends (as defined in section
24 1388 (a)), to the extent paid in money, qualified writ-
25 ten notices of allocation (as defined in section 1388

(c)), or other property (except nonqualified written notices of allocation (as defined in section 1388 (d))) with respect to patronage occurring during such taxable year; or

“(2) in money or other property (except written notices of allocation) in redemption of a nonqualified written notice of allocation which was paid as a patronage dividend during the payment period for the taxable year during which the patronage occurred.

For purposes of this title, any amount not taken into account under the preceding sentence shall be treated in the same manner as an item of gross income and as a deduction therefrom.

“(c) DEDUCTION FOR NONPATRONAGE DISTRIBUTIONS, ETC.—In determining the taxable income of an organization described in section 1381 (a) (1), there shall be allowed as a deduction (in addition to other deductions allowable under this chapter) —

“(1) amounts paid during the taxable year as dividends on its capital stock; and

“(2) amounts paid during the payment period for the taxable year—

“(A) in money, qualified written notices of allocation, or other property (except nonqualified written notices of allocation) on a patronage basis

1 to patrons with respect to its earnings during such
2 taxable year which are derived from business done
3 for the United States or any of its agencies or from
4 sources other than patronage, or

5 “(B) in money or other property (except writ-
6 ten notices of allocation) in redemption of a non-
7 qualified written notice of allocation which was paid,
8 during the payment period for the taxable year dur-
9 ing which the earnings were derived, on a patron-
10 age basis to a patron with respect to earnings de-
11 rived from business or sources described in subpara-
12 graph (A).

13 “(d) PAYMENT PERIOD FOR EACH TAXABLE YEAR.—
14 For purposes of subsections (b) and (c) (2), the payment
15 period for any taxable year is the period beginning with the
16 first day of such taxable year and ending with the fifteenth
17 day of the ninth month following the close of such year.

18 “(e) PRODUCTS MARKETING UNDER POOLING AR-
19 RANGEMENTS.—For purposes of subsection (b), in the case
20 of a pooling arrangement for the marketing of products, the
21 patronage shall (to the extent provided in regulations pre-
22 scribed by the Secretary or his delegate) be treated as
23 patronage occurring during the taxable year in which the
24 pool closes.

25 “(f) TREATMENT OF EARNINGS RECEIVED AFTER

1 PATRONAGE OCCURRED.—If any portion of the earnings
 2 from business done with or for patrons is includible in the
 3 organization's gross income for a taxable year after the
 4 taxable year during which the patronage occurred, then for
 5 purposes of applying subsection (b) to such portion the
 6 patronage shall, to the extent provided in regulations pre-
 7 scribed by the Secretary or his delegate, be considered to
 8 have occurred during the taxable year of the organization
 9 during which such earnings are includible in gross income.

10 "SEC. 1383. COMPUTATION OF TAX WHERE COOPERATIVE
 11 REDEEMS NONQUALIFIED WRITTEN NO-
 12 TICES OF ALLOCATION.

13 "(a) GENERAL RULE.—If, under section 1382 (b) (2)
 14 or (c) (2) (B), a deduction is allowable to an organization
 15 for the taxable year for amounts paid in redemption of non-
 16 qualified written notices of allocation, then the tax imposed
 17 by this chapter on such organization for the taxable year
 18 shall be the lesser of the following:

19 "(1) the tax for the taxable year computed with
 20 such deduction; or

21 "(2) an amount equal to—

22 "(A) the tax for the taxable year computed
 23 without such deduction, minus

24 "(B) the decrease in tax under this chapter
 25 for any prior taxable year (or years) which would

1 result solely from treating such nonqualified written
2 notices of allocation as qualified written notices of
3 allocation.

4 “(b) SPECIAL RULES.—

5 “(1) If the decrease in tax ascertained under sub-
6 section (a) (2) (B) exceeds the tax for the taxable year
7 (computed without the deduction described in subsection
8 (a)) such excess shall be considered to be a payment
9 of tax on the last day prescribed by law for the payment
10 of tax for the taxable year, and shall be refunded or
11 credited in the same manner as if it were an overpay-
12 ment for such taxable year.

13 “(2) For purposes of determining the decrease in
14 tax under subsection (a) (2) (B), the stated dollar
15 amount of any nonqualified written notice of allocation
16 which is to be treated under such subsection as a quali-
17 fied written notice of allocation shall be the amount paid
18 in redemption of such written notice of allocation which
19 is allowable as a deduction under section 1382 (b) (2)
20 or (c) (2) (B) for the taxable year.

21 “(3) If the tax imposed by this chapter for the tax-
22 able year is the amount determined under subsection
23 (a) (2), then the deduction described in subsection (a)
24 shall not be taken into account for any purpose of this
25 subtitle other than for purposes of this section.

1 **"PART II—TAX TREATMENT BY PATRONS OF PA-**
2 **TRONAGE DIVIDENDS**

"Sec. 1385. Amounts includible in patron's gross income.

3 **"SEC. 1385. AMOUNTS INCLUDIBLE IN PATRON'S GROSS**
4 **INCOME.**

5 **"(a) GENERAL RULE.**—Except as otherwise provided
6 in subsection (b), each person shall include in gross
7 income—

8 **"(1)** the amount of any patronage dividend which
9 is paid in money, a qualified written notice of allocation,
10 or other property (except a nonqualified written notice
11 of allocation), and which is received by him during the
12 taxable year from an organization described in section
13 1381 (a), and

14 **"(2)** any amount, described in section 1382 (c) (2)
15 (A) (relating to certain nonpatronage distributions by
16 tax-exempt farmers' cooperatives), which is paid in
17 money, a qualified written notice of allocation, or other
18 property (except a nonqualified written notice of alloca-
19 tion), and which is received by him during the taxable
20 year from an organization described in section 1381 (a)
21 (1).

22 **"(b) EXCLUSION FROM GROSS INCOME.**—Under regu-
23 lations prescribed by the Secretary or his delegate, the

1 amount of any patronage dividend, and any amount re-
 2 ceived on the redemption, sale, or other disposition of a non-
 3 qualified written notice of allocation which was paid as a
 4 patronage dividend, shall not be included in gross income to
 5 the extent that such amount—

6 “(1) is properly taken into account as an adjust-
 7 ment to basis of property, or

8 “(2) is attributable to personal, living, or family
 9 items.

10 “(c) TREATMENT OF CERTAIN NONQUALIFIED WRIT-
 11 TEN NOTICES OF ALLOCATION.—

12 “(1) APPLICATION OF SUBSECTION.—This sub-
 13 section shall apply to any nonqualified written notice of
 14 allocation which—

15 “(A) was paid as a patronage dividend, or

16 “(B) was paid by an organization described in
 17 section 1381 (a) (1) on a patronage basis with re-
 18 spect to earnings derived from business or sources
 19 described in section 1382 (c) (2) (A).

20 “(2) BASIS; AMOUNT OF GAIN.—In the case of
 21 any nonqualified written notice of allocation to which
 22 this subsection applies, for purposes of this chapter—

23 “(A) the basis of such written notice of alloca-
 24 tion in the hands of the patron to whom such written
 25 notice of allocation was paid shall be zero,

“(B) the basis of such written notice of allocation which was acquired from a decedent shall be its basis in the hands of the decedent, and

“(C) gain on the redemption, sale, or other disposition of such written notice of allocation by any person shall, to the extent that the stated dollar amount of such written notice of allocation exceeds its basis, be considered as gain from the sale or exchange of property which is not a capital asset.

“PART III—DEFINITIONS; SPECIAL RULES

“Sec. 1388. Definitions; special rules.

“SEC. 1388. DEFINITIONS; SPECIAL RULES.

“(a) PATRONAGE DIVIDEND.—For purposes of this subchapter, the term ‘patronage dividend’ means an amount paid to a patron by an organization to which part I of this subchapter applies—

“(1) on the basis of quantity or value of business done with or for such patron,

“(2) under an obligation of such organization to pay such amount, which obligation existed before the organization received the amount so paid, and

“(3) which is determined by reference to the net earnings of the organization from business done with or for its patrons.

1 Such term does not include any amount paid to a patron to
2 the extent that (A) such amount is out of earnings other
3 than from business done with or for patrons, or (B)
4 such amount is out of earnings from business done with or
5 for other patrons to whom no amounts are paid, or to whom
6 smaller amounts are paid, with respect to substantially
7 identical transactions.

8 “(b) WRITTEN NOTICE OF ALLOCATION.—For pur-
9 poses of this subchapter, the term ‘written notice of alloca-
10 tion’ means any capital stock, revolving fund certificate,
11 retain certificate, certificate of indebtedness, letter of advice,
12 or other written notice, which discloses to the recipient the
13 stated dollar amount allocated to him by the organization
14 and the portion thereof, if any, which constitutes a patronage
15 dividend.

16 “(c) QUALIFIED WRITTEN NOTICE OF ALLOCATION.—

17 “(1) DEFINED.—For purposes of this subchapter,
18 the term ‘qualified written notice of allocation’ means—

19 “(A) a written notice of allocation which may
20 be redeemed in cash at its stated dollar amount at
21 any time within a period beginning on the date such
22 written notice of allocation is paid and ending not
23 earlier than 90 days from such date, but only if the
24 distributee receives written notice of the right of

redemption at the time he receives such written notice of allocation; and

“(B) a written notice of allocation which the distributee has consented, in the manner provided in paragraph (2), to take into account at its stated dollar amount as provided in section 1385 (a).

“(2) MANNER OF OBTAINING CONSENT.—A distributee shall consent to take a written notice of allocation into account as provided in paragraph (1) (B) only by—

“(A) making such consent in writing, or

“(B) obtaining or retaining membership in the organization after—

“(i) such organization has adopted (after the date of the enactment of the Revenue Act of 1962) a bylaw providing that membership in the organization constitutes such consent, and

“(ii) he has received a written notification and copy of such bylaw.

“(3) PERIOD FOR WHICH CONSENT IS EFFECTIVE.—

“(A) GENERAL RULE.—Except as provided in subparagraph (B) —

“(i) a consent described in paragraph

1 (2) (A) shall be a consent with respect to all
2 patronage of the distributee with the organiza-
3 tion occurring (determined with the application
4 of section 1382 (e)) during the taxable year of
5 the organization during which such consent is
6 made and all subsequent taxable years of the
7 organization; and

8 “(ii) a consent described in paragraph
9 (2) (B) shall be a consent with respect to all
10 patronage of the distributee with the organiza-
11 tion occurring (determined without the applica-
12 tion of section 1382 (e)) after he received the
13 notification and copy described in paragraph
14 (2) (B) (ii) .

15 “(B) REVOCATION, ETC.—

16 “(i) Any consent described in paragraph
17 (2) (A) may be revoked (in writing) by the
18 distributee at any time. Any such revocation
19 shall be effective with respect to patronage
20 occurring on or after the first day of the first
21 taxable year of the organization beginning after
22 the revocation is filed with such organization;
23 except that in the case of a pooling arrangement
24 described in section 1382 (e) , a revocation made
25 by a distributee shall not be effective as to any

pool with respect to which the distributee has been a patron before such revocation.

“(ii) Any consent described in paragraph (2) (B) shall not be effective with respect to any patronage occurring (determined without the application of section 1382 (e)) after the distributee ceases to be a member of the organization or after the bylaws of the organization cease to contain the provision described in paragraph (2) (B) (i) .

“(d) NONQUALIFIED WRITTEN NOTICE OF ALLOCATION.—For purposes of this subchapter, the term ‘nonqualified written notice of allocation’ means a written notice of allocation which is not described in subsection (c) .

“(e) DETERMINATION OF AMOUNT PAID OR RECEIVED.—For purposes of this subchapter, in determining amounts paid or received—

“(1) property (other than a written notice of allocation) shall be taken into account at its fair market value, and

“(2) a qualified written notice of allocation shall be taken into account at its stated dollar amount.”

(b) TECHNICAL AMENDMENTS.—

(1) Section 521 (a) (relating to exemption of farm-

1 ers' cooperatives from tax) is amended by striking out
 2 "section 522" each place it appears therein and inserting
 3 in lieu thereof "part I of subchapter T (sec. 1381 and
 4 following)".

5 (2) Section 522 (relating to tax on farmers' coop-
 6 eratives) is hereby repealed.

7 (3) Section 6044 (relating to returns regarding
 8 patronage dividends) is amended to read as follows:

9 **"SEC. 6044. RETURNS REGARDING PATRONAGE DIVI-**
 10 **DENDS.**

11 "Any organization to which part I of subchapter T of
 12 chapter 1 (relating to tax treatment of cooperatives) ap-
 13 plies which pays amounts described in section 1382 (b), or
 14 (in the case of an organization described in section 1381
 15 (a) (1)) amounts described in section 1382 (c) (2), shall,
 16 when required by regulations of the Secretary or his delegate,
 17 make a return showing—

18 "(1) the name and address of each patron to whom
 19 it has made such payments during the calendar year; and

20 "(2) the amount of such payments to each patron."

21 (4) Section 6072 (d) (relating to time for filing
 22 income tax returns of exempt cooperative associations)
 23 is amended to read as follows:

24 "(d) RETURNS OF COOPERATIVE ASSOCIATIONS.—In
 25 the case of an income tax return of—

1 “(1) an exempt cooperative association described
2 in section 1381 (a) (1), or

3 “(2) an organization described in section 1381
4 (a) (2) which is under an obligation to pay patronage
5 dividends (as defined in section 1388 (a)) in an
6 amount equal to at least 50 percent of its net earnings
7 from business done with or for its patrons, or which
8 paid patronage dividends in such an amount out of the
9 net earnings from business done with or for patrons dur-
10 ing the most recent taxable year for which it had such
11 net earnings,

12 a return made on the basis of a calendar year shall be filed
13 on or before the 15th day of September following the close
14 of the calendar year, and a return made on the basis of a
15 fiscal year shall be filed on or before the 15th day of the 9th
16 month following the close of the fiscal year.”

17 (5) The table of subchapters for chapter 1 is
18 amended by adding at the end thereof the following:

“SUBCHAPTER T. Cooperatives and their patrons.”

19 (6) The table of sections for part III of subchapter
20 F of chapter 1 is amended by striking out the last line
21 thereof.

22 (c) EFFECTIVE DATES.—

23 (1) FOR THE COOPERATIVES.—Except as provided

1 in paragraph (3), the amendments made by subsections
2 (a) and (b) shall apply to taxable years of organiza-
3 tions described in section 1381 (a) of the Internal Reve-
4 nue Code of 1954 (as added by subsection (a)) begin-
5 ning after December 31, 1962.

6 (2) FOR THE PATRONS.—Except as provided in
7 paragraph (3), section 1385 of the Internal Revenue
8 Code of 1954 (as added by subsection (a)) shall
9 apply with respect to any amount received from any
10 organization described in section 1381 (a) of such Code,
11 to the extent that such amount is paid by such organiza-
12 tion in a taxable year of such organization beginning
13 after December 31, 1962.

14 (3) APPLICATION OF EXISTING LAW.—In the case
15 of any money, written notice of allocation, or other prop-
16 erty paid by any organization described in section
17 1381 (a) —

18 (A) before the first day of the first taxable
19 year of such organization beginning after December
20 31, 1962, or

21 (B) on or after such first day with respect to
22 patronage occurring before such first day,
23 the tax treatment of such money, written notice of allo-
24 cation, or other property (including the tax treatment of
25 gain or loss on the redemption, sale, or other disposition

of such written notice of allocation) by any person shall be made under the Internal Revenue Code of 1954 without regard to subchapter T of chapter 1 of such Code.

SEC. 18. INCLUSION OF FOREIGN REAL PROPERTY IN GROSS ESTATE.

(a) AMENDMENTS TO INCLUDE FOREIGN REAL PROPERTY.—

(1) Section 2031 (a) (relating to definition of gross estate) is amended by striking out “, except real property situated outside of the United States”.

(2) The following provisions of chapter 11 (imposing an estate tax) are amended by striking out “(except real property situated outside of the United States)”:

(A) section 2033 (relating to property in which the decedent had an interest),

(B) section 2034 (relating to dower or curtesy interests),

(C) section 2035 (a) (relating to transactions in contemplation of death),

(D) section 2036 (a) (relating to transfers with retained life estate),

(E) section 2037 (a) (relating to transfers taking effect at death),

(F) section 2038 (a) (relating to revocable transfers),

1 (G) section 2040 (relating to joint interests),
2 and

3 (H) section 2041 (a) (relating to powers of
4 appointment).

5 (b) EFFECTIVE DATE.—

6 (1) Except as provided in paragraph (2), the
7 amendments made by subsection (a) shall apply to the
8 estates of decedents dying after the date of the enactment
9 of this Act.

10 (2) In the case of a decedent dying after the date
11 of the enactment of this Act and before July 1, 1964,
12 the value of real property situated outside of the United
13 States shall not be included in the gross estate (as defined
14 in section 2031 (a)) of the decedent—

15 (A) under section 2033, 2034, 2035 (a),
16 2036 (a), 2037 (a), or 2038 (a) to the extent the
17 real property, or the decedent's interest in it, was
18 acquired by the decedent before February 1, 1962;

19 (B) under section 2040 to the extent such
20 property or interest was acquired by the decedent
21 before February 1, 1962, or was held by the de-
22 cent and the survivor in a joint tenancy or tenancy
23 by the entirety before February 1, 1962; or

24 (C) under section 2041 (a) to the extent that
25 before February 1, 1962, such property or interest

1 was subject to a general power of appointment (as
2 defined in section 2041) possessed by the decedent.

3 In the case of real property, or an interest therein, sit-
4 uated outside of the United States (including a general
5 power of appointment in respect of such property or
6 interest, and including property held by the decedent
7 and the survivor in a joint tenancy or tenancy by the
8 entirety) which was acquired by the decedent after
9 January 31, 1962, by gift within the meaning of sec-
10 tion 2511, or from a prior decedent by devise or inheri-
11 tance, or by reason of death, form of ownership, or other
12 conditions (including the exercise or nonexercise of a
13 power of appointment), for purposes of this paragraph
14 such property or interest therein shall be deemed to have
15 been acquired by the decedent before February 1, 1962,
16 if before that date the donor or prior decedent had
17 acquired the property or his interest therein or had
18 possessed a power of appointment in respect of the prop-
19 erty or interest.

20 **SEC. 19. WITHHOLDING OF INCOME TAX AT SOURCE ON**
21 **INTEREST, DIVIDENDS, AND PATRONAGE DIVI-**
22 **DENDS.**

23 (a) IN GENERAL.—

24 (1) AMENDMENT OF SUBTITLE C.—Subtitle C (re-
25 lating to employment taxes and collection of income tax

1 at source) is amended by redesignating chapter 25 as
 2 chapter 26 and by inserting after chapter 24 the follow-
 3 ing new chapter:

4 **“CHAPTER 25—COLLECTION OF INCOME TAX**
 5 **AT SOURCE ON INTEREST, DIVIDENDS,**
 6 **AND PATRONAGE DIVIDENDS**

“SUBCHAPTER A. Interest.

“SUBCHAPTER B. Dividends.

“SUBCHAPTER C. Patronage dividends.

“SUBCHAPTER D. General provisions.

7 **“Subchapter A—Interest**

“Sec. 3451. Income tax collected at source on interest.

“Sec. 3452. Interest defined.

8 **“SEC. 3451. INCOME TAX COLLECTED AT SOURCE ON**
 9 **INTEREST.**

10 **“(a) REQUIREMENT OF WITHHOLDING.—**Except as
 11 otherwise provided in this chapter, every person who pays
 12 interest shall deduct and withhold on such interest a tax
 13 equal to 20 percent of the amount thereof.

14 **“(b) PAYEE UNKNOWN.—**If the withholding agent is
 15 unable to determine the person to whom the interest is pay-
 16 able, the tax under this section shall be deducted and with-
 17 held at the time payment of the interest would be made if
 18 such person were known.

1 “(c) CROSS REFERENCES.—

 “(1) For credit, against income tax of the recipient of the income, of amounts deducted and withheld under this section, see section 39.

 “(2) For special rules as to credit or refund of such amounts, see sections 3484, 3485, 3486, 3487, and 3505.

 “(3) For exemption from requirement of deducting and withholding on certain interest paid to certain persons, see section 3483.

2 “SEC. 3452. INTEREST DEFINED.

3 “(a) GENERAL RULE.—For purposes of this chapter,
4 the term ‘interest’ means—

5 “(1) interest on evidences of indebtedness (includ-
6 ing bonds, debentures, notes, and certificates) issued by
7 a corporation with interest coupons or in registered
8 form, and, to the extent provided in regulations pre-
9 scribed by the Secretary or his delegate, interest on
10 other evidences of indebtedness issued by a corporation
11 of a type offered by corporations to the public;

12 “(2) interest on deposits with persons carrying on
13 the banking business;

14 “(3) amounts (whether or not designated as in-
15 terest) paid by a mutual savings bank, savings and loan
16 association, building and loan association, cooperative
17 bank, homestead association, credit union, or similar

1 organization, in respect of deposits, investment certifi-
2 cates, or withdrawable or repurchasable shares;

3 “(4) interest on amounts held by an insurance com-
4 pany under an agreement to pay interest thereon;

5 “(5) interest on deposits with stockbrokers;

6 “(6) interest on obligations of the United States;

7 and

8 “(7) in the case of a non-interest-bearing obliga-
9 tion of the United States—

10 “(A) issued on a discount basis, and

11 “(B) having a maturity date more than one
12 year from the date of issue,

13 the amount by which the amount paid on surrender or
14 redemption exceeds the issue price.

15 “(b) EXCEPTIONS.—For purposes of this chapter, the
16 term ‘interest’ does not include—

17 “(1) interest on obligations described in section
18 103 (a) (1) or (3) (relating to interest on certain
19 governmental obligations) ;

20 “(2) any amount paid by—

21 “(A) a foreign government or international
22 organization,

23 “(B) a foreign corporation not engaged in
24 trade or business within the United States,

25 “(C) a nonresident alien individual not en-

gaged in trade or business within the United States,
or

“(D) a partnership not engaged in trade or
business within the United States and composed in
whole or in part of nonresident aliens;

“(3) interest on deposits with persons carrying on
the banking business paid to a person described in para-
graph (2) (B), (C), or (D);

“(4) any amount paid by one corporation to an-
other corporation, if both corporations are members of
the same affiliated group which filed a consolidated re-
turn for the preceding taxable year of the affiliated
group;

“(5) interest subject to withholding under subchap-
ter A of chapter 3 (sec. 1441 and following, relating to
withholding of tax on nonresident aliens and foreign cor-
porations) by the person paying such interest, or which
would be so subject to withholding by such person, but
for the fact that it is not treated as income from sources
within the United States;

“(6) any amount on which the withholding agent
is required to deduct and withhold a tax under section
1451 (relating to tax-free covenant bonds), or would be
so required but for section 1451 (d) (relating to benefit
of personal exemptions);

1 “(7) to the extent provided in regulations pre-
 2 scribed by the Secretary or his delegate, any amount
 3 payable with respect to deposits in school savings
 4 accounts; and

5 “(8) any amount described in subsection (a) (2),
 6 (3), or (7) paid to a State or a foreign government
 7 or international organization (other than any amount
 8 described in subsection (a) (3) paid in respect of a
 9 transferable certificate or share).

10 “(c) EXEMPTION FOR UNITED STATES.—The Secre-
 11 tary may authorize exemption from the tax imposed by sec-
 12 tion 3451 for any amount paid by the United States or
 13 any wholly owned agency or instrumentality thereof to the
 14 United States or any wholly owned agency or instrumentality
 15 thereof if the Secretary determines that the imposition
 16 of the tax with respect to such amount will cause a burden
 17 or expense which can be avoided by granting the tax
 18 exemption.

19 “Subchapter B—Dividends

“Sec. 3461. Income tax collected at source on dividends.

“Sec. 3462. Dividend defined.

20 “SEC. 3461. INCOME TAX COLLECTED AT SOURCE ON 21 DIVIDENDS.

22 “(a) REQUIREMENT OF WITHHOLDING.—Except as
 23 otherwise provided in this chapter, every person who pays

1 a dividend shall deduct and withhold on such dividend a tax
2 equal to 20 percent of the amount thereof.

3 “(b) PAYEE UNKNOWN.—If the withholding agent is
4 unable to determine the person to whom the dividend is
5 payable, the tax under this section shall be deducted and
6 withheld at the time payment of the dividend would be
7 made if such person were known.

8 “(c) AMOUNT OF DIVIDEND UNKNOWN.—If the with-
9 holding agent is unable to determine the portion of a dis-
10 tribution which is a dividend, the tax under this section
11 shall be computed on the entire amount of the distribution.

12 “(d) CROSS REFERENCES.—

“(1) For credit, against income tax of the recipient of
the income, of amounts deducted and withheld under this
section, see section 39.

“(2) For special rules as to credit or refund of such
amounts, see sections 3484, 3485, 3486, 3487, and 3505.

“(3) For exemption from requirement of deducting
and withholding on dividends paid to certain individuals,
see section 3483.

13 “SEC. 3462. DIVIDEND DEFINED.

14 “(a) GENERAL RULE.—For purposes of this chapter,
15 the term ‘dividend’ means—

16 “(1) any distribution by a corporation which is a
17 dividend (as defined in section 316) ; and

18 “(2) any payment made by a stockbroker to any
19 person as a substitute for a dividend (as so defined).

20 “(b) EXCEPTIONS.—For purposes of this chapter, the
21 term ‘dividend’ does not include—

1 “(1) any amount paid in the stock, or rights to
2 acquire the stock, of the distributing corporation if the
3 distribution is not includible in gross income of the re-
4 cipient under the provisions of section 305 (relating to
5 distributions of stock and stock rights) ;

6 “(2) any distribution to the extent that, under
7 chapter 1—

8 “(A) the amount thereof is treated by the re-
9 cipient as an amount received on the sale or ex-
10 change of property, or

11 “(B) gain or loss to the recipient is not recog-
12 nized;

13 “(3) any amount which is includible in gross in-
14 come as a taxable dividend by reason of the provisions
15 of section 302 (relating to redemptions of stock), 306
16 (relating to dispositions of certain stock), 356 (relating
17 to receipt of additional consideration in connection with
18 certain reorganizations), or 1081(e) (2) (relating to
19 certain distributions pursuant to order of the Securities
20 and Exchange Commission) ;

21 “(4) any amount paid by one corporation to an-
22 other corporation, if both corporations are members of
23 the same affiliated group which filed a consolidated re-
24 turn for the preceding taxable year of the affiliated
25 group;

1 “(5) an amount which—

2 “(A) is subject to withholding under subchap-
3 ter A of chapter 3 (sec. 1441 and following, relating
4 to withholding of tax on nonresident aliens and for-
5 eign corporations) by the person paying such
6 amount, or

7 “(B) would be subject to withholding under
8 such subchapter A by the person paying such
9 amount but for—

10 “(i) the fact that it is attributable to in-
11 come from sources outside the United States, or

12 “(ii) the fact that the payor thereof is
13 excepted from the application of section
14 1441 (a) by the provisions of section 1441 (c) ;

15 “(6) any amount paid by a foreign corporation not
16 engaged in trade or business within the United States;

17 “(7) any amount described in section 1373 (relat-
18 ing to undistributed taxable income of electing small
19 business corporations) ; and

20 “(8) amounts paid pursuant to the terms of a
21 lease entered into before January 1, 1954, if under such
22 lease the shareholders of the lessor corporation are en-
23 titled to such amounts without deduction for any tax
24 which any law of the United States might require to be
25 deducted and withheld on the payment of dividends.

1 **“Subchapter C—Patronage Dividends**

“Sec. 3471. Income tax collected at source on patronage dividends.

“Sec. 3472. Amounts subject to withholding.

2 **“SEC. 3471. INCOME TAX COLLECTED AT SOURCE ON** 3 **PATRONAGE DIVIDENDS.**

4 “(a) **REQUIREMENT OF WITHHOLDING.**—Except as
 5 otherwise provided in this chapter, every cooperative to
 6 which part I of subchapter T of chapter 1 applies which pays
 7 an amount described in section 3472 shall deduct and with-
 8 hold on such amount a tax equal to 20 percent of such
 9 amount.

10 “(b) **PAYEE UNKNOWN.**—If the withholding agent is
 11 unable to determine the person to whom the amount is pay-
 12 able, the tax under this section shall be deducted and with-
 13 held at the time payment of the amount would be made if
 14 such person were known.

15 “(c) **CROSS REFERENCES.**—

“**(1) For credit, against income tax of the recipient of the income, of amounts deducted and withheld under this section, see section 39.**

“**(2) For special rules as to credit or refund of such amounts, see sections 3484, 3485, 3486, 3487, and 3505.**

“**(3) For exemption from requirement of deducting and withholding on amounts paid to certain individuals, see section 3483.**

16 **“SEC. 3472. AMOUNTS SUBJECT TO WITHHOLDING.**

17 “(a) **GENERAL RULE.**—Except as otherwise provided
 18 in this section or section 3483, the amounts subject to deduc-
 19 tion and withholding under section 3471 are—

1 “(1) the amount of any patronage dividend (as
 2 defined in section 1388 (a)) which is paid in money,
 3 qualified written notices of allocation (as defined in sec-
 4 tion 1388 (c)), or other property (except nonqualified
 5 written notices of allocation as defined in section
 6 1388 (d)), and

7 “(2) any amount, described in section 1382 (c) (2)
 8 (A) (relating to certain nonpatronage distributions),
 9 which is paid in money, qualified written notices of al-
 10 location, or other property (except nonqualified written
 11 notices of allocation) by an organization exempt from
 12 tax under section 521 (relating to exemption of farm-
 13 ers’ cooperatives from tax).

14 “(b) EXCEPTIONS.—The provisions of section 3471
 15 shall not apply to—

16 “(1) any amount paid by one corporation to an-
 17 other corporation, if both corporations are members of
 18 the same affiliated group which filed a consolidated re-
 19 turn for the preceding taxable year of the affiliated
 20 group;

21 “(2) an amount which—

22 “(A) is subject to withholding under sub-
 23 chapter A of chapter 3 (sec. 1441 and following,
 24 relating to withholding of tax on nonresident aliens

1 and foreign corporations) by the person paying such
2 amount, or

3 “(B) would be subject to withholding under
4 such subchapter A by the person paying such
5 amount but for the fact that it is attributable to
6 income from sources outside the United States; and

7 “(3) any amount paid by a foreign corporation
8 not engaged in trade or business within the United
9 States.

10 “(c) EXEMPTION FOR CERTAIN CONSUMER COOPERA-
11 TIVES.—A cooperative which the Secretary or his delegate
12 determines is primarily engaged in selling at retail goods
13 or services of a type that are generally for personal, living,
14 or family use shall, upon application to the Secretary or his
15 delegate, be granted exemption from the tax imposed by
16 section 3471. Application for exemption under this sub-
17 section shall be made in accordance with regulations pre-
18 scribed by the Secretary or his delegate.

19 “(d) DETERMINATION OF AMOUNT PAID.—For pur-
20 poses of this subchapter, in determining amounts paid—

21 “(1) property (other than a written notice of
22 allocation) shall be taken into account at its fair market
23 value, and

24 “(2) a qualified written notice of allocation shall
25 be taken into account at its stated dollar amount.

“Subchapter D—General Provisions

“Sec. 3481. Liability for return and payment of withheld tax.

“Sec. 3482. Return and payment by United States.

“Sec. 3483. Exemption certificates.

“Sec. 3484. Refund of tax to individuals.

“Sec. 3485. Refund of tax to States, tax-exempt organizations, etc.

“Sec. 3486. Refund of tax to corporation.

“Sec. 3487. Credit for tax withheld on corporation.

“Sec. 3488. Obligation sold between interest-payment dates.

“Sec. 3489. Presumption.

“Sec. 3490. Definitions.

“SEC. 3481. LIABILITY FOR RETURN AND PAYMENT OF WITHHELD TAX.

“(a) **GENERAL RULE.**—Every person required to deduct and withhold any tax under this chapter shall, on or before the last day of the first month following the close of each quarter of his taxable year, make a return of the tax required to be deducted and withheld during such quarter and pay the tax to the officer designated in section 6151. The withholding agent shall be liable for the payment of the taxes required to be deducted and withheld under this chapter, and shall not otherwise be liable to any person for the amount of any such payment.

“(b) **TAX PAID BY RECIPIENT.**—If the withholding agent, in violation of the provisions of this chapter, fails to deduct and withhold any tax under this chapter, and thereafter the tax against which such tax may be credited is paid, the tax so required to be deducted and withheld shall

1 not be collected from the withholding agent; but this sub-
2 section shall in no case relieve the withholding agent from
3 liability for any penalties or additions to the tax otherwise
4 applicable in respect of such failure to deduct and withhold.

5 “(c) CROSS REFERENCE.—

“For limitation on the use of Government depositaries
in the collection of taxes deducted and withheld under
this chapter, see the last sentence of section 6302(c).

6 “SEC. 3482. RETURN AND PAYMENT BY UNITED STATES.

7 “If the withholding agent is the United States the re-
8 turn of the tax deducted and withheld under this chapter may
9 be made by an officer or employee of the United States
10 having control of the payment of the amount subject to
11 withholding, or appropriately designated for that purpose.

12 “SEC. 3483. EXEMPTION CERTIFICATES.

13 “(a) GENERAL RULES.—

14 “(1) INDIVIDUALS UNDER AGE 18.—Any indi-
15 vidual may file with any withholding agent an exemp-
16 tion certificate on which he certifies the date of his
17 birth. If such a certificate is filed, all amounts pay-
18 able by such withholding agent to such individual, on
19 and after the effective date for such certificate and
20 before the beginning of the calendar year during which
21 the certificate indicates that he will attain age 18, shall
22 be exempt from the requirement of deducting and with-
23 holding under this chapter.

1 “(2) INDIVIDUALS OVER AGE 17.—Any individual
2 may file with any withholding agent an exemption
3 certificate on which he certifies—

4 “(A) that he will have attained age 18 before
5 the close of the calendar year for which such certifi-
6 cate is filed, and

7 “(B) that he reasonably believes that he will
8 not (after the application of the credits against tax
9 provided by part IV of subchapter A of chapter 1,
10 other than the credits under sections 31 and 39) be
11 liable for the payment of any tax under chapter 1 for
12 each of his taxable years any portion of which is
13 included in the period for which such certificate
14 will be in effect.

15 If such a certificate is filed, all amounts payable by such
16 withholding agent to such individual during the period
17 such certificate is in effect shall be exempt from the
18 requirement of deducting and withholding under this
19 chapter. Except as may otherwise be provided in regu-
20 lations prescribed by the Secretary or his delegate, an
21 exemption certificate filed by an individual described in
22 this paragraph shall remain in effect only for the period
23 beginning on the effective date of such certificate and

1 ending at the close of the calendar year in which such
2 period begins.

3 “(3) TAX-EXEMPT ORGANIZATIONS.—

4 “(A) Any organization (other than a coopera-
5 tive described in section 521) which is exempt from
6 the tax imposed by chapter 1 may file with any
7 withholding agent who pays amounts described in
8 section 3452 (a) (2), (3), or (7) an exemption
9 certificate on which it certifies that it is such an
10 organization. If such a certificate is filed, all
11 amounts described in section 3452 (a) (2),
12 (3), and (7) payable by such withholding agent
13 to such organization on and after the effective date
14 for such certificate shall (except as provided in sub-
15 paragraph (B)) be exempt from the requirement
16 of deducting and withholding under this chapter.

17 “(B) An exemption certificate filed by an
18 organization under subparagraph (A) shall cease
19 to be effective on the thirtieth day after the day on
20 which the withholding agent, with whom such cer-
21 tificate was filed, is notified by either the organiza-
22 tion or the Secretary or his delegate that the
23 organization is no longer exempt from the tax im-
24 posed by chapter 1. If an organization ceases to be
25 exempt from such tax, it shall, within the time speci-

1 fied in regulations prescribed by the Secretary or his
2 delegate, so notify each withholding agent with
3 whom it has an exemption certificate in effect.

4 “(b) EXCEPTIONS AND SPECIAL RULES.—

5 “(1) CERTAIN EXCEPTIONS.—This section shall
6 not apply to any amount—

7 “(A) described in section 3452 (a) (1) (re-
8 lating to interest on evidences of indebtedness),

9 “(B) described in section 3452 (a) (3) paid
10 in respect of a transferable certificate or share, or

11 “(C) described in section 3452 (a) (6) (relat-
12 ing to interest on obligations of the United States).

13 “(2) SERIES E BONDS, ETC.—In the case of trans-
14 actions involving the redemption of one or more obliga-
15 tions described in section 3452 (a) (7) (relating to cer-
16 tain obligations of the United States issued on a discount
17 basis), a separate certificate shall be filed with respect
18 to each such transaction.

19 “(3) NOMINEES, CUSTODIANS, AND JOINT OWNER-
20 SHIPS.—Under regulations prescribed by the Secretary
21 or his delegate, the exemption provided by subsection
22 (a) may be extended, in a manner consistent with the
23 other provisions of this section, to—

24 “(A) amounts (other than amounts described

1 in section 3462 (a), relating to dividends) paid
2 through nominees;

3 “(B) amounts paid to custodians; and

4 “(C) amounts paid jointly to 2 or more
5 individuals.

6 “(4) EFFECTIVE DATE OF CERTIFICATE.—Any
7 exemption certificate under this section shall take effect
8 on such day as is specified in accordance with regula-
9 tions prescribed by the Secretary or his delegate.

10 “(5) FORM AND CONTENTS OF CERTIFICATE AND
11 NOTICE.—Any exemption certificate under this section,
12 and any notice under subsection (a) (3) (B), shall be
13 in such form and contain such information as the Secre-
14 tary or his delegate may by regulations prescribe.

15 “(c) CROSS REFERENCE.—

“For penalty for filing fraudulent certificate, or for
failing to provide notice, under this section, see section
7205.

16 **“SEC. 3484. REFUND OF TAX TO INDIVIDUALS.**

17 “(a) GENERAL RULE.—Except as provided in subsec-
18 tion (e), the tax deducted and withheld under this chapter
19 with respect to amounts received by an individual during
20 any quarter (other than the fourth quarter) of his taxable
21 year (together with any tax so deducted and withheld on
22 amounts which were received by him during any prior quar-
23 ter of such year and with respect to which no allowable claim

1 for refund has been filed under this section) shall, to the
2 extent such tax does not exceed his refund allowance as of
3 the time the claim for refund is filed, be promptly refunded
4 to him as an overpayment of tax. A refund of tax shall be
5 made under this section only if the amount claimed and
6 allowable equals or exceeds \$10.

7 “(b) REFUND ALLOWANCE.—For purposes of this sec-
8 tion, the refund allowance of an individual as of the time the
9 claim for refund is filed is an amount equal to the excess, if
10 any, of—

11 “(1) an amount equal to 22 percent of—

12 “(A) the total of the deductions which, on the
13 basis of facts existing at the time the claim for refund
14 is filed, such individual would be allowed for the tax-
15 able year under section 151 (relating to deductions
16 for personal exemptions), plus

17 “(B) in the case of an individual who, at the
18 time the claim for refund is filed, reasonably ex-
19 pects that he will be allowed a credit under section
20 37 (relating to retirement income) for the taxable
21 year, the amount which, at such time, such individ-
22 ual reasonably expects to be the amount of his
23 retirement income (as defined in section 37 (c) and
24 as limited by section 37 (d)) for the taxable year,
25 less

1 “(C) the amounts (other than amounts on
2 which tax is required to be deducted and withheld
3 under this chapter) which, at the time the claim for
4 refund is filed, such individual reasonably expects
5 to be includible in his gross income for the taxable
6 year; over

7 “(2) the amounts of tax with respect to which an
8 allowable claim for refund has been previously filed
9 under this section during the taxable year.

10 For purposes of paragraph (1) (C), an individual who
11 files more than one claim for refund under this section for
12 any taxable year may use the estimate for the preceding
13 claim for such year unless, at the time he files the claim,
14 he reasonably expects the amounts referred to in paragraph
15 (1) (C) to exceed such prior estimate by more than \$100.

16 “(c) **MARRIED INDIVIDUALS.**—For purposes of subsec-
17 tions (a), (b), and (d), married individuals shall be treated
18 as an individual if, at the time the claim for refund is filed,
19 they reasonably expect that they will file a joint return for
20 the taxable year in which such claim is filed.

21 “(d) **TIME FOR FILING CLAIM.**—Not more than one
22 claim may be filed under this section by any individual
23 during any quarter of his taxable year. A refund of tax
24 deducted and withheld on amounts received during a taxable

1 year shall be made under this section only if claim therefor
2 is filed on or before the last day of such taxable year.

3 “(e) INDIVIDUALS NOT ELIGIBLE FOR REFUND.—No
4 claim for refund may be filed under this section by—

5 “(1) any individual (other than an individual
6 referred to in paragraph (2) or (3)) unless, at the
7 time the claim for refund is filed, he reasonably expects
8 that his gross income for the taxable year will not ex-
9 ceed \$5,000;

10 “(2) any married individual unless, at the time the
11 claim for refund is filed, he reasonably expects that the
12 aggregate gross income of such individual and his spouse
13 for the taxable year will not exceed \$10,000;

14 “(3) a head of a household (as defined in section
15 1 (b) (2)) or a surviving spouse (as defined in section
16 2 (b)) unless, at the time the claim for refund is filed,
17 he reasonably expects that his gross income for the
18 taxable year will not exceed \$10,000; or

19 “(4) any child, unless, at the time the claim for
20 refund is filed, he reasonably expects that no deduction
21 would be allowed for him under section 151 (e) (1) (B)
22 for the taxable year of his parent (or parents) begin-
23 ning with or within the calendar year in which the
24 claim for refund is filed.

1 “(f) CROSS REFERENCE.—

 “**For credit or refund of amounts not refunded under
this section, see section 39.**

2 “**SEC. 3485. REFUND OF TAX TO STATES, TAX-EXEMPT**
3 **ORGANIZATIONS, ETC.**

4 “(a) GENERAL RULE.—In the case of a person which
5 is—

6 “(1) the United States or a State,

7 “(2) an organization (other than a cooperative
8 described in section 521) which is exempt from the tax
9 imposed by chapter 1,

10 “(3) a foreign government or international organi-
11 zation, or

12 “(4) a foreign central bank of issue,

13 if the tax deducted and withheld under this chapter with re-
14 spect to amounts received by such person during any calendar
15 quarter exceeds the credit, if any, claimed by and allowable
16 to such person under section 3505 (relating to credit against
17 employment taxes) for such quarter, the excess (together
18 with any such excess for any prior quarter of the same
19 calendar year with respect to which no refund has been
20 claimed and allowed under this section) shall be promptly
21 refunded or credited to such person as an overpayment of
22 tax. In the case of a person to which paragraph (4) ap-
23 plies, the amount which may be refunded or credited under

1 this section shall not exceed the amount of tax deducted
2 and withheld under section 3451 on interest paid on obliga-
3 tions of the United States which are not held for, or used in
4 connection with, the conduct of commercial banking functions
5 or other commercial activities.

6 “(b) CROSS REFERENCES.—

“ (1) For period of limitation for filing claim under this section, see section 6511.

“ (2) For presumed date of payment for purposes of (A) period of limitation, see section 6513(b), and (B) allowance of interest on overpayments, see section 6611(d).

7 “SEC. 3486. REFUND OF TAX TO CORPORATION.

8 “(a) GENERAL RULE.—If the tax deducted and with-
9 held under this chapter with respect to amounts received by
10 a corporation (other than a corporation described in section
11 3485 (a)) during any quarter (other than the fourth quar-
12 ter) of its taxable year exceeds the amount claimed by and
13 allowable to such corporation under section 3487 as a credit
14 against its liability for tax under this chapter for such quar-
15 ter, the excess (together with any such excess for any prior
16 quarter of the same year with respect to which no refund has
17 been claimed and allowed under this section) shall be
18 promptly refunded or credited to such corporation as an over-
19 payment of tax. A refund of tax shall be made under this
20 section only if claim therefor is filed after the close of the
21 period covered by the claim and on or before the last day
22 of the taxable year.

1 “(b) CROSS REFERENCE.—

 “For credit or refund of amounts not refunded under
this section, see section 39.

2 “SEC. 3487. CREDIT FOR TAX WITHHELD ON CORPO-
3 RATION.

4 “(a) GENERAL RULE.—Any tax deducted and with-
5 held under this chapter with respect to amounts received
6 by a corporation (other than a corporation described in sec-
7 tion 3485 (a)) during a taxable year shall, to the extent not
8 claimed and allowable as a credit or refund to the corporation
9 under section 3486, be allowed, under regulations prescribed
10 by the Secretary or his delegate, as a credit against (but
11 not in excess of) the tax for which such corporation is liable
12 under this chapter in respect of amounts paid by it during
13 such year.

14 “(b) DIVIDENDS AND PATRONAGE DIVIDENDS PAID
15 DURING TAXABLE YEAR.—For purposes of determining the
16 credit allowable to any corporation under subsection (a) , a
17 dividend, or amount subject to withholding under section
18 3471, paid by it may be considered as having been paid
19 during the taxable year—

20 “(1) in the case of a personal holding company, if
21 treated as paid during such taxable year under section
22 563 (b) ,

23 “(2) in the case of a regulated investment com-

pany, if treated as paid during such taxable year under section 855 (a) ,

“(3) in the case of a real estate investment trust, if treated as paid during such taxable year under section 858 (a) , or

“(4) in the case of a cooperative described in section 1381 (a) , if paid during the payment period (as defined in section 1382 (d)) for such taxable year.

“(c) SPECIAL RULE FOR CORPORATIONS WHICH ARE MEMBERS OF AN AFFILIATED GROUP.—To the extent and subject to such conditions as may be provided in regulations prescribed by the Secretary or his delegate, the tax deducted and withheld under this chapter with respect to amounts received by a corporation which is a member of an affiliated group which filed a consolidated return for the preceding taxable year of the affiliated group may, for purposes of this section, be treated as tax deducted and withheld under this chapter from any corporation which is a member of the same affiliated group.

“SEC. 3488. OBLIGATION SOLD BETWEEN INTEREST-PAYMENT DATES.

“For purposes of any credit or refund provided in section 3484, 3485, 3486, or 3487, in the case of an obligation which is sold or exchanged between interest-payment dates the amount required to be deducted and withheld on

1 the interest at the end of the interest-payment period shall
2 be treated in the manner provided in section 39(c).

3 **"SEC. 3489. PRESUMPTION.**

4 "For purposes of establishing that any person is entitled
5 to a credit or refund of any tax required to be deducted and
6 withheld under this chapter with respect to amounts received
7 by such person, the correct amount of such tax shall, in the
8 absence of evidence to the contrary, be presumed to have
9 been so deducted and withheld.

10 **"SEC. 3490. DEFINITIONS.**

11 "For purposes of this chapter—

12 "(1) **PERSON.**—The term 'person' includes the
13 United States, a State, a foreign government, and an
14 international organization.

15 "(2) **STATE.**—The term 'State' includes a State, the
16 District of Columbia, a possession of the United States,
17 any political subdivision of any of the foregoing, and any
18 wholly owned agency or instrumentality of any one or
19 more of the foregoing.

20 "(3) **FOREIGN GOVERNMENT.**—The term 'foreign
21 government' includes a foreign government, a politi-
22 cal subdivision of a foreign government, and any wholly

owned agency or instrumentality of any one or more of the foregoing.

“(4) NONRESIDENT ALIEN.—The term ‘nonresident alien individual’ includes an alien resident of Puerto Rico.”

(2) CLERICAL AMENDMENTS, ETC.—

(A) The heading for subtitle C is amended to read as follows:

“Subtitle C—Employment Taxes and Collection of Income Tax at Source”

(B) The table of chapters for subtitle C is amended by striking out the last line and inserting in lieu thereof the following:

“CHAPTER 25. Collection of income tax at source on interest, dividends, and patronage dividends.

“CHAPTER 26. General provisions relating to employment taxes and collection of income taxes at source.”

(C) The table of subtitles under the heading “Internal Revenue Title” at the beginning of the Internal Revenue Code of 1954 is amended by striking out the third line and inserting in lieu thereof the following:

“SUBTITLE C. Employment taxes and collection of income tax at source.”

1 (D) The heading for chapter 26 (as redesign-
2 nated by paragraph (1) of this subsection) is
3 amended to read as follows:

4 **“CHAPTER 26—GENERAL PROVISIONS RE-**
5 **LATING TO EMPLOYMENT TAXES AND**
6 **COLLECTION OF INCOME TAXES AT**
7 **SOURCE”**

8 (b) CREDITS AGAINST INCOME TAX FOR TAX WITH-
9 HELD.—

10 (1) ALLOWANCE OF CREDIT.—Part IV of sub-
11 chapter A of chapter 1 (relating to credits against tax)
12 is amended by inserting after section 38 (added by
13 section 2 of this Act) the following new section:

14 **“SEC. 39. TAX WITHHELD ON INTEREST, DIVIDENDS, AND**
15 **PATRONAGE DIVIDENDS.**

16 “(a) GENERAL RULE.—Under regulations prescribed
17 by the Secretary or his delegate, the tax deducted and with-
18 held under chapter 25 (relating to withholding at source
19 on interest, dividends, and patronage dividends) shall be
20 allowed, to the recipient of the amount with respect to which
21 such tax was deducted and withheld, as a credit against the
22 tax imposed by this subtitle for the taxable year in which
23 such amount is received.

24 “(b) SPECIAL RULE FOR DEPENDENT CHILDREN.—If—

25 “(1) the taxpayer for his taxable year is entitled

1 to a deduction under section 151 (e) (1) (B) with re-
2 spect to a child, and

3 “(2) such child had, for the calendar year ending
4 with or within the taxpayer’s taxable year—

5 “(A) gross income of less than \$600, and

6 “(B) no wages (as defined in section 3401
7 (a)) with respect to which withholding was re-
8 quired under chapter 24,

9 then, under regulations prescribed by the Secretary or his
10 delegate, the taxpayer shall be entitled to the credit pro-
11 vided by subsection (a) with respect to amounts received
12 by such child during such calendar year, but only if such
13 child has not filed any claim for credit or refund of any por-
14 tion of the tax deducted and withheld with respect to such
15 amounts.

16 “(c) APPORTIONMENT OF CREDIT.—For purposes of
17 subsection (a) , if an obligation is sold or exchanged between
18 interest-payment dates—

19 “(1) so much of the amount required to be deducted
20 and withheld on the interest at the end of the interest-
21 payment period as is properly allocable to that part of
22 such period which ends on the date of the sale or ex-
23 change shall be treated as an amount deducted and with-
24 held from the transferor on the date of the sale or
25 exchange, and

1 “(2) so much of such amount as is properly al-
2 locable to that part of such period which begins on the
3 day after the date of the sale or exchange shall be treated
4 as an amount deducted and withheld from the transferee.

5 “(d) LIMITATIONS.—The credit provided by subsection
6 (a) shall not be allowed—

7 “(1) REFUND TO INDIVIDUALS.—To any indi-
8 vidual with respect to any amount of tax allowed him
9 as a refund under section 3484.

10 “(2) CREDIT OR REFUND TO STATES, ETC.—To
11 any person with respect to any amount of tax allowable
12 to such person as a credit or refund under section 3485
13 or as a credit under section 3505.

14 “(3) CREDIT OR REFUND TO CORPORATIONS.—To
15 any person with respect to any amount of tax allowed
16 such person as a credit or refund under section 3486 or
17 as a credit under section 3487.

18 “(4) CERTAIN DEPENDENT CHILDREN.—To any
19 person with respect to any amount of tax which has
20 been claimed and is allowable as a credit to such
21 person’s parent by reason of the provisions of subsection
22 (b).

23 “(5) NOMINEES, ETC.—To any person with respect
24 to any amount of tax allowed such person as a credit
25 under section 1444 (b).”

1 (2) COMMON TRUST FUNDS.—Section 584 (c) (re-
2 lating to the income of participants in the fund) is
3 amended by adding at the end thereof the following
4 new paragraph:

5 “(3) TAX WITHHELD AT SOURCE ON INTEREST,
6 DIVIDENDS, AND PATRONAGE DIVIDENDS.—In any case
7 where tax under chapter 25 is deducted and withheld
8 on any amounts received by a common trust fund, for
9 purposes of any credit or refund provided in section 39
10 or 3505, or chapter 25, such tax shall, in accordance
11 with regulations prescribed by the Secretary or his dele-
12 gate, be considered as having been deducted and with-
13 held proportionately from each participant.”

14 (3) ESTATES AND TRUSTS.—Section 642 (a) (re-
15 lating to special rules for credits and deductions in the
16 case of estates and trusts) is amended by adding at the
17 end thereof the following new paragraph:

18 “(4) TAX WITHHELD AT SOURCE ON INTEREST,
19 DIVIDENDS, AND PATRONAGE DIVIDENDS.—In any case
20 where tax under chapter 25 is deducted and withheld
21 on any amounts received by an estate or trust, for pur-
22 poses of any credit or refund provided in section 39
23 or 3505, or chapter 25, such tax shall, in accordance
24 with regulations prescribed by the Secretary or his dele-
25 gate, be considered as having been deducted and with-

1 held from each beneficiary in an amount which, when
2 added to the amounts paid, credited, or required to be
3 distributed to him, equals the amounts which would
4 have been paid, credited, or required to be distributed
5 to him in the absence of chapter 25. Any tax under
6 chapter 25 which is deducted and withheld on amounts
7 received by the estate or trust shall be considered as
8 withheld from such estate or trust to the extent it is
9 not considered as withheld from a beneficiary under
10 the provisions of the preceding sentence.”

11 (4) TECHNICAL AMENDMENTS.—

12 (A) Section 164(b) (1) (relating to deduc-
13 tion denied in the case of certain taxes) is amended
14 by—

15 (i) striking out the word “and” at the end
16 of subparagraph (B) ;

17 (ii) striking out the comma at the end of
18 subparagraph (C) and inserting “; and”; and

19 (iii) adding after subparagraph (C) the
20 following new subparagraph:

21 “(D) the tax withheld at source under chapter

1 25 (relating to collection of income tax at source
2 on interest, dividends, and patronage dividends),”.

3 (B) Section 874 (a) (relating to allowance of
4 deductions and credits to nonresident alien indi-
5 viduals) is amended by striking “31 and 32” and
6 inserting in lieu thereof “31, 32, and 39”.

7 (C) Section 1314 (e) (relating to inapplica-
8 bility of part II of subchapter Q of chapter 1 of
9 subtitle A to taxes imposed by subtitle C) is
10 amended by striking “employment taxes” and in-
11 sserting in lieu thereof “employment taxes and
12 collection of income tax at source”.

13 (D) Section 6211 (b) (1) (relating to rules
14 applicable in determination of deficiency) is
15 amended by striking “31” and inserting in lieu
16 thereof “31 or 39”.

17 (E) The table of sections for part IV of sub-
18 chapter A of chapter 1 is amended by striking out
19 “Sec. 38. Overpayments of tax.”
and inserting in lieu thereof

“Sec. 38. Investment in certain depreciable property.

“Sec. 39. Tax withheld on interest, dividends, and patronage
dividends.

“Sec. 40. Overpayments of tax.”

1 (c) INTEREST AND DIVIDENDS PAID TO NONRESIDENT
2 ALIENS, ETC.—

3 (1) WITHHOLDING RATE.—

4 (A) Section 1441 (relating to withholding of
5 tax on nonresident aliens) is amended by adding at
6 the end thereof the following new subsection:

7 “(e) TREATIES.—In the case of amounts described in
8 section 3452 (a) (relating to interest), section 3462 (a)
9 (relating to dividends), and section 3472 (a) (relating to
10 patronage dividends), the tax required to be deducted and
11 withheld under subsection (a) shall not by reason of the
12 provisions of any treaty be less than 20 percent of such
13 amounts.”

14 (B) Section 1442 (relating to withholding of
15 tax on foreign corporations) is amended by adding
16 at the end thereof the following new sentence: “In
17 the case of amounts described in section 3452 (a)
18 (relating to interest), section 3462 (a) (relating to
19 dividends), and section 3472 (a) (relating to pa-
20 tronage dividends), the tax required to be deducted
21 and withheld under the preceding sentence shall
22 not by reason of the provisions of any treaty be
23 less than 20 percent of such amounts.”

24 (2) NOMINEES, ETC.—Subchapter A of chapter
25 3 (relating to withholding of tax on nonresident aliens

1 and foreign corporations) is amended by adding at the
2 end thereof the following new section:

3 **"SEC. 1444. INTEREST AND DIVIDENDS PAID TO NOMI-**
4 **NEES; CREDITS TO WITHHOLDING AGENTS.**

5 " (a) **WITHHOLDING OF TAX BY PAYOR.**—Under regu-
6 lations prescribed by the Secretary or his delegate, every
7 person who pays amounts subject to withholding under
8 chapter 25 and who has been notified by a payee thereof that
9 the payee is a nominee required to deduct and withhold
10 on such amounts under section 1441 or 1442 shall, in
11 lieu of the nominee, deduct and withhold from such amounts
12 paid to the nominee the tax required to be deducted and
13 withheld under section 1441 or 1442, in the same manner
14 as if such amounts were paid by such person directly to the
15 beneficial owner thereof.

16 " (b) **CREDITS TO WITHHOLDING AGENTS.**—In the case
17 of any person who is required to deduct and withhold tax
18 under section 1441 or 1442 in respect of amounts received
19 by him during any calendar year on which tax was deducted
20 and withheld (or, in the case of amounts described in section
21 39 (c) (1), was treated as deducted and withheld) under
22 chapter 25, the taxes so deducted and withheld (or treated
23 as deducted and withheld) under chapter 25 shall, under
24 regulations prescribed by the Secretary or his delegate, be
25 allowed as a credit against (but not in excess of) his liability

1 for the year in respect of the taxes imposed by sections 1441
2 and 1442.”

3 (3) CLERICAL AMENDMENT.—The table of sec-
4 tions for subchapter A of chapter 3 is amended by add-
5 ing at the end thereof the following:

“Sec. 1444. Interest and dividends paid to nominees; credits
to withholding agents.”

6 (d) CREDIT FOR STATES AND TAX-EXEMPT ORGANI-
7 ZATIONS.—

8 (1) ALLOWANCE OF CREDIT.—Chapter 26 (gen-
9 eral provisions relating to employment taxes and income
10 tax withheld at source) is amended by adding at the
11 end thereof the following new section:

12 “SEC. 3505. SPECIAL CREDIT IN CASE OF STATES OR TAX-
13 EXEMPT ORGANIZATIONS.

14 “(a) GENERAL RULE.—In the case of a person which is
15 a State (as defined in section 3490 (2)) or which is an or-
16 ganization (other than a cooperative described in section
17 521) which is exempt from the tax imposed by chapter
18 1, the tax deducted and withheld under chapter 25 with
19 respect to amounts received by it during any calendar
20 quarter shall be allowed, under regulations prescribed
21 by the Secretary or his delegate, as a credit against
22 (but not in excess of) such person’s liability (after the
23 adjustments, if any, provided for in sections 6205 (a)

1 and 6413 (a)) for such quarter in respect of the taxes
2 imposed by chapter 21 (Federal Insurance Contributions
3 Act) and by chapter 24 (collection of income tax at source
4 on wages). Such credit shall be allowed only if claim
5 therefor is made, in accordance with such regulations, at the
6 time of the filing of the return with respect to the taxes under
7 chapter 21 and chapter 24 for such quarter.

8 “(b) OBLIGATIONS SOLD BETWEEN INTEREST-PAY-
9 MENT DATES.—For purposes of this section, in the case of
10 an obligation which is sold or exchanged between interest-
11 payment dates, the amount required to be deducted and with-
12 held on the interest at the end of the interest-payment period
13 shall be treated in the manner provided in section 39 (c).

14 “(c) CROSS REFERENCE.—

“For refund under chapter 25, see section 3485.”

15 (2) TECHNICAL AMENDMENTS.—

16 (A) Section 3502 (relating to nondeductibil-
17 ity of taxes in computing taxable income) is
18 amended by adding at the end thereof the following
19 new subsection:

20 “(c) The tax deducted and withheld under chapter 25
21 shall not be allowed as a deduction in computing taxable
22 income under subtitle A either to the person deducting and
23 withholding the tax or to the recipient of the amounts sub-
24 ject to withholding.”

1 (B) The table of sections for chapter 26 is
2 amended by adding at the end thereof the following:

“Sec. 3505. Special credit in case of States or tax-exempt organizations.”

3 (e) OTHER TECHNICAL AMENDMENTS.—

4 (1) DECLARATION OF ESTIMATED INCOME TAX
5 BY INDIVIDUALS.—Section 6015 (a) (relating to dec-
6 laration of estimated income tax by individuals) is
7 amended by striking out the period at the end of para-
8 graph (2) and inserting in lieu thereof “and amounts on
9 which tax is required to be deducted and withheld under
10 chapter 25.”.

11 (2) ADJUSTMENT OF TAX; UNDERPAYMENT.—

12 (A) Subsection (a) (1) of section 6205 (re-
13 lating to special rules relating to assessment of em-
14 ployment taxes) is amended by striking out "or
15 3402 is paid with respect to any payment of
16 wages or compensation," and inserting in lieu there-
17 of "3402, 3451, 3461, or 3471 is paid with respect
18 to any payment of remuneration, interest, divi-
19 dends, or other amounts,".

20 (B) Subsection (b) of such section is amended
21 by striking out "or 3402 is paid or deducted with re-
22 spect to any payment of wages or compensation"
23 and inserting in lieu thereof "3402, 3451, 3461, or

3471 is paid or deducted with respect to any payment of remuneration, interest, dividends, or other amounts”.

(C) The heading for such section is amended to read as follows:

“SEC. 6205. SPECIAL RULES APPLICABLE TO CERTAIN TAXES UNDER SUBTITLE C.”

(D) The table of sections for subchapter A of chapter 63 is amended by striking out

“Sec. 6205. Special rules applicable to certain employment taxes.”

and inserting in lieu thereof

“Sec. 6205. Special rules applicable to certain taxes under subtitle C.”

(3) **USE OF GOVERNMENT DEPOSITARIES.**—Section 6302 (c) (relating to use of Government depositaries) is amended by adding at the end thereof the following new sentence: “The Secretary or his delegate shall not require the deposit under this subsection of any tax deducted and withheld under chapter 25 (relating to collection of income tax at source on interest, dividends, and patronage dividends) in a Government depositary before the last day prescribed in section 3481 for payment of the tax.”

(4) **EXCESSIVE WITHHOLDING.**—Section 6401

1 (b) (relating to excessive withholding) is amended to
2 read as follows:

3 “(b) EXCESSIVE WITHHOLDING.—If the amounts al-
4 lowable as credits under section 31 (relating to credit for tax
5 withheld at source under chapter 24) and section 39 (relat-
6 ing to credit for tax withheld on interest, dividends, and
7 patronage dividends under chapter 25) exceed the taxes
8 imposed by chapter 1 against which such credits are allow-
9 able, the amount of such excess shall be considered an over-
10 payment.”

11 (5) ADJUSTMENT OF TAX; OVERPAYMENT.—

12 (A) Subsection (a) (1) of section 6413 (re-
13 lating to special credit and refund rules applicable
14 to certain employment taxes) is amended by striking
15 out “or 3402 is paid with respect to any payment
16 of remuneration,” and inserting in lieu thereof
17 “3402, 3451, 3461, or 3471 is paid with respect
18 to any payment of remuneration, interest, dividends,
19 or other amounts,”.

20 (B) Subsection (b) of such section is
21 amended—

22 (i) By striking from the heading of such
23 subsection the words “OF CERTAIN EMPLOY-
24 MENT TAXES”; and

25 (ii) By striking out “or 3402 is paid or

deducted with respect to any payment of remuneration” and inserting in lieu thereof “3402, 3451, 3461, or 3471 is paid or deducted with respect to any payment of remuneration, interest, dividends, or other amounts”.

(C) The following new subsection is added at the end of such section:

“(e) CROSS REFERENCES.—

“For special refunds or credits of tax withheld on interest, dividends, or patronage dividends under chapter 25, see sections 3484, 3485, 3486, 3487, and 3505.”

(D) The heading for such section is amended to read as follows:

“SEC. 6413. SPECIAL RULES APPLICABLE TO CERTAIN TAXES UNDER SUBTITLE C.”

(E) The table of sections for subchapter B of chapter 65 is amended by striking out

“Sec. 6413. Special rules applicable to certain employment taxes.”

and inserting in lieu thereof.

“Sec. 6413. Special rules applicable to certain taxes under subtitle C.”

(6) OVERPAYMENT NOT DEDUCTED AND WITHHELD.—Section 6414 (relating to income tax withheld) is amended by striking “chapter 3” and inserting in lieu thereof “chapter 3 or 25”.

1 (7) TIME TAX CONSIDERED PAID.—Section 6513
2 (b) (relating to time tax considered paid) is amended
3 by adding at the end thereof the following new sen-
4 tences: “For purposes of section 6511 or 6512, any
5 tax deducted and withheld under chapter 25 which is
6 allowable under section 39, 3484, 3485, or 3486
7 as a credit against tax or as a refund of an overpayment
8 (or an amount treated as an overpayment) of the tax
9 imposed by chapter 1 shall, in respect of the person en-
10 titled to such credit or refund, be deemed to have been
11 paid by him on the last day prescribed for filing the re-
12 turn (determined without regard to any extension of
13 time for filing such return) of tax under chapter 1 for
14 his taxable year in which the amount subject to with-
15 holding under chapter 25 is received by him or, if such
16 person has no taxable year, on the fifteenth day of the
17 fifth calendar month following the close of such person’s
18 annual accounting period within which such amount
19 is received by him. In the case of an amount allowable
20 as a credit under section 39 (b) to the parent of a child,
21 such amount shall, if claimed by the parent, be deemed
22 to have been paid on the last day for filing his return
23 (determined without regard to any extension of time
24 for filing such return) for his taxable year which begins
25 with or within the calendar year in which amounts sub-

ject to withholding under chapter 25 were received by the child.”

(8) FAILURE TO PAY ESTIMATED INCOME TAX.—

(A) INDIVIDUALS.—Subsections (e) and (f) of section 6654 (relating to failure by individual to pay estimated income tax) are amended to read as follows:

“(e) APPLICATION OF SECTION IN CASE OF WITHHELD TAXES.—For purposes of applying this section—

“(1) the estimated tax shall be computed without any reduction for amounts which the individual estimates as his credits under section 31 (relating to tax withheld at source on wages) and section 39 (relating to tax withheld on interest, dividends, and patronage dividends); and

“(2) the amount of the credits allowed under sections 31 and 39 for the taxable year shall be deemed a payment of estimated tax, and an equal part of such amount shall be deemed paid on each installment date (determined under section 6153) for such taxable year, unless the taxpayer establishes the dates on which all amounts were actually withheld (or in the case of amounts described in section 39(c)(1), were treated as withheld), in which case the amounts so withheld

1 shall be deemed payments of estimated tax on such
2 dates.

3 “(f) TAX COMPUTED AFTER APPLICATION OF
4 CREDITS AGAINST TAX.—For purposes of subsections (b)
5 and (d), the term ‘tax’ means the tax imposed by chapter
6 1 reduced by the credits against tax allowed by part IV of
7 subchapter A of chapter 1, other than the credits against
8 tax provided by section 31 (relating to tax withheld on
9 wages) and section 39 (relating to tax withheld on interest,
10 dividends, and patronage dividends).”

11 (B) CORPORATIONS.—Section 6655 (relating
12 to failure by corporation to pay estimated income
13 tax) is amended—

14 (i) by striking out the period at the end
15 of subsection (e) (2) (B) and inserting in lieu
16 thereof “, other than the credit against tax
17 provided by section 39 (relating to tax with-
18 held on interest, dividends, and patronage divi-
19 dends).”; and

20 (ii) by redesignating subsection (f) as
21 subsection (g) and inserting after subsection
22 (e) the following new subsection:

23 “(f) APPLICATION OF SECTION IN CASE OF TAX
24 WITHHELD ON INTEREST, DIVIDENDS, AND PATRONAGE
25 DIVIDENDS.—For purposes of applying this section—

1 “(1) the estimated tax shall be computed without
2 any reduction for the amount which the corporation
3 estimates as its credit under section 39 (relating to tax
4 withheld on interest, dividends, and patronage divi-
5 dends) ; and

6 “(2) the amount of the credit allowed under sec-
7 tion 39 for the taxable year shall be deemed a payment
8 of estimated tax, and an equal part of such amount shall
9 be deemed paid on each installment date (determined
10 under section 6154) for such taxable year, unless the
11 corporation establishes the dates on which all amounts
12 were actually withheld (or in the case of amounts de-
13 scribed in section 39 (c) (1) , were treated as withheld) ,
14 in which case the amounts so withheld shall be deemed
15 payments of estimated tax on such dates.”

16 (9) **PENALTY FOR FILING FRAUDULENT EXEMP-**
17 **TION CERTIFICATE.**—Section 7205 (relating to fraudu-
18 lent withholding exemption certificate or failure to sup-
19 ply information) is amended by adding the following
20 new sentence at the end thereof: “Any person who
21 willfully files an exemption certificate with any with-
22 holding agent under section 3483, on which the certifica-
23 tion is known by him to be fraudulent or to be false as
24 to any material matter, or who is required to file a notice

1 under subsection (a) (3) (B) of section 3483 and who
2 willfully fails to provide such notice in the manner, at
3 the time, and showing the information required under
4 such subsection (a) (3) (B), or the regulations pre-
5 scribed thereunder, shall, in lieu of any penalty otherwise
6 provided, upon conviction thereof, be fined not more than
7 \$500, or imprisoned not more than 1 year, or both."

8 (10) OFFENSES WITH RESPECT TO COLLECTED
9 TAXES.—The last sentence of section 7215 (b) (relating
10 to offenses with respect to collected taxes) is amended to
11 read as follows: "For purposes of paragraph (2), a lack
12 of funds existing immediately after the payment of wages
13 or amounts subject to withholding under chapter 25
14 (whether or not created by the payment of such wages
15 or amounts) shall not be considered to be circumstances
16 beyond the control of a person."

17 (11) DEFINITION OF WITHHOLDING AGENT.—Sec-
18 tion 7701 (a) (16) (defining the term "withholding
19 agent") is amended by striking out "or 1461" and in-
20 serting in lieu thereof "1461, 3451, 3461, or 3471".

21 (f) EFFECTIVE DATES.—

22 (1) GENERAL RULE.—Except as provided in para-
23 graph (2), the provisions of this section shall apply in
24 the case of interest and dividends paid on or after Jan-
25 uary 1, 1963.

(2) SPECIAL RULES.—

(A) In the case of transferable obligations described in paragraph (1) or (6) of section 3452 (a) of the Internal Revenue Code of 1954, the provisions of this section shall apply only to interest paid with respect to interest-payment periods commencing on or after January 1, 1963.

(B) The provisions of this section shall apply to amounts described in section 3472 of such Code paid on or after January 1, 1963, with respect to patronage occurring on or after the first day of the first taxable year of the cooperative beginning on or after January 1, 1963.

SEC. 20. INFORMATION WITH RESPECT TO CERTAIN FOREIGN ENTITIES.

(a) INFORMATION TO BE FURNISHED BY INDIVIDUALS, DOMESTIC CORPORATIONS, ETC., WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.—Section 6038 is amended to read as follows:

“SEC. 6038. INFORMATION WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.

“(a) REQUIREMENT.—

“(1) IN GENERAL.—Every United States person shall furnish, with respect to any foreign corporation which such person controls (within the meaning of

1 subsection (d) (1)), such information as the Secretary
2 or his delegate may prescribe by regulations relating to—

3 “(A) the name, the principal place of busi-
4 ness, and the nature of business of such foreign
5 corporation, and the country under whose laws
6 incorporated;

7 “(B) the accumulated profits (as defined in
8 section 902 (c)) of such foreign corporation, in-
9 cluding the items of income (whether or not in-
10 cluded in gross income under chapter 1) , deductions
11 (whether or not allowed in computing taxable in-
12 come under chapter 1) , and any other items taken
13 into account in computing such accumulated profits;

14 “(C) a balance sheet for such foreign corpora-
15 tion listing assets, liabilities, and capital;

16 “(D) transactions between such foreign cor-
17 poration and—

18 “(i) such person,

19 “(ii) any other corporation which such
20 person controls, and

21 “(iii) any United States person owning,
22 at the time the transaction takes place, 10 per-
23 cent or more of the value of any class of stock
24 outstanding of such foreign corporation; and

25 “(E) a description of the various classes of

1 stock outstanding, and a list showing the name and
2 address of, and number of shares held by, each
3 United States person who is a shareholder of record
4 owning at any time during the annual accounting
5 period 5 percent or more in value of any class of
6 stock outstanding of such foreign corporation.

7 The Secretary or his delegate may also require the fur-
8 nishing of any other information which is similar or
9 related in nature to that specified in the preceding
10 sentence.

11 “(2) PERIOD FOR WHICH INFORMATION IS TO BE
12 FURNISHED, ETC.—The information required under para-
13 graph (1) shall be furnished for the annual accounting
14 period of the foreign corporation ending with or within
15 the United States person’s taxable year. The informa-
16 tion so required shall be furnished at such time and in
17 such manner as the Secretary or his delegate shall by
18 regulations prescribe.

19 “(3) LIMITATION.—No information shall be re-
20 quired to be furnished under this subsection with respect
21 to any foreign corporation for any annual accounting
22 period unless such information was required to be fur-
23 nished under regulations in effect on the first day of such
24 annual accounting period.

1 “(b) EFFECT OF FAILURE TO FURNISH INFORMA-
2 TION.—

3 “(1) IN GENERAL.—If a United States person fails
4 to furnish, within the time prescribed under paragraph
5 (2) of subsection (a), any information with respect to
6 any foreign corporation required under paragraph (1)
7 of subsection (a), then—

8 “(A) in applying section 901 (relating to
9 taxes of foreign countries and possessions of the
10 United States) to such United States person for the
11 taxable year, the amount of taxes (other than taxes
12 reduced under subparagraph (B)) paid or deemed
13 paid (other than those deemed paid under section
14 904(d)) to any foreign country or possession of the
15 United States for the taxable year shall be reduced
16 by 10 percent, and

17 “(B) in applying sections 902 (relating to
18 foreign tax credit for corporate stockholder in
19 foreign corporation) and 957 (relating to special
20 rules for foreign tax credit) to any such United
21 States person which is a corporation (or to any per-
22 son who acquires from any other person any portion
23 of the interest of such other person in any such foreign
24 corporation, but only to the extent of such portion)
25 for any taxable year, the amount of taxes paid or

1 deemed paid by each foreign corporation with re-
2 spect to which such person is required to furnish
3 information during the annual accounting period or
4 periods with respect to which such information is
5 required under paragraph (2) of subsection (a)
6 shall be reduced by 10 percent.

7 If such failure continues 90 days or more after notice
8 by the Secretary or his delegate to the United States
9 person, then the amount of the reduction under this
10 subsection shall be 10 percent plus an additional 5 per-
11 cent for each 3-month period, or fraction thereof, dur-
12 ing which such failure to furnish information continues
13 after the expiration of such 90-day period.

14 “(2) SPECIAL RULES.—

15 “(A) No taxes shall be reduced under this sub-
16 section more than once for the same failure.

17 “(B) For purposes of this subsection, the time
18 prescribed under paragraph (2) of subsection (a)
19 to furnish information (and the beginning of the
20 90-day period after notice by the Secretary) shall
21 be treated as being not earlier than the last day on
22 which (as shown to the satisfaction of the Secretary
23 of his delegate) reasonable cause existed for failure
24 to furnish such information.

25 “(C) In applying subsections (a) and (b) of

1 section 902, and in applying subsection (a) of sec-
2 tion 956, the reduction provided by this subsec-
3 tion shall not apply for purposes of determining the
4 amount of accumulated profits in excess of in-
5 come, war profits, and excess profits taxes.

6 “(c) TWO OR MORE PERSONS REQUIRED TO FURNISH
7 INFORMATION WITH RESPECT TO SAME FOREIGN COR-
8 PORATION.—Where, but for this subsection, two or more
9 United States persons would be required to furnish informa-
10 tion under subsection (a) with respect to the same foreign
11 corporation for the same period, the Secretary or his dele-
12 gate may by regulations provide that such information shall
13 be required only from one person. To the extent practicable,
14 the determination of which person shall furnish the informa-
15 tion shall be made on the basis of actual ownership of stock.

16 “(d) DEFINITIONS.—For purposes of this section—

17 “(1) CONTROL.—A person is in control of a cor-
18 poration if such person owns stock possessing more than
19 50 percent of the total combined voting power of all
20 classes of stock entitled to vote, or more than 50 per-
21 cent of the total value of shares of all classes of stock,
22 of a corporation. If a person is in control (within the
23 meaning of the preceding sentence) of a corporation

which in turn owns more than 50 percent of the total combined voting power of all classes of stock entitled to vote of another corporation, or owns more than 50 percent of the total value of the shares of all classes of stock of another corporation, then such person shall be treated as in control of such other corporation. For purposes of this paragraph, the rules prescribed by section 318 (a) for determining ownership of stock shall apply; except that clause (i) of section 318 (a) (2) (C) shall be applied without regard to the 50 percent limitation contained in such section.

“(2) ANNUAL ACCOUNTING PERIOD.—The annual accounting period of a foreign corporation is the annual period on the basis of which such corporation regularly computes its income in keeping its books.

“(e) CROSS REFERENCES.—

“(1) For provisions relating to penalties for violations of this section, see section 7203.

“(2) For definition of the term ‘United States person’, see section 7701(a)(30).”

(b) INFORMATION AS TO ORGANIZATION OR REORGANIZATION OF FOREIGN CORPORATIONS AND AS TO ACQUISITIONS OF THEIR STOCK.—Section 6046 (relating to

1 returns as to creation or organization, or reorganization, of
2 foreign corporations) is amended to read as follows:

3 **"SEC. 6046. RETURNS AS TO ORGANIZATION OR REORGAN-**
4 **IZATION OF FOREIGN CORPORATIONS AND**
5 **AS TO ACQUISITIONS OF THEIR STOCK.**

6 **"(a) REQUIREMENT OF RETURN.**—A return comply-
7 ing with the requirements of subsection (b) shall be made
8 by—

9 **"(1)** each United States citizen or resident who
10 is an officer or director of a foreign corporation on Jan-
11 uary 1, 1963, or who becomes such an officer or director
12 at any time after such date,

13 **"(2)** each United States person who on January
14 1, 1963, owns 5 percent or more in value of the stock
15 of a foreign corporation, or who, at any time after such
16 date—

17 **"(A)** acquires stock which, when added to any
18 stock owned on January 1, 1963, has a value equal
19 to 5 percent or more of the value of the stock of a
20 foreign corporation, or

21 **"(B)** acquires an additional 5 percent or more
22 in value of the stock of a foreign corporation, and

23 **"(3)** each person who at any time after January 1,
24 1963, becomes a United States person while owning

1 5 percent or more in value of the stock of a foreign
2 corporation.

3 “(b) FORM AND CONTENTS OF RETURNS.—The re-
4 turns required by subsection (a) shall be in such form and
5 shall set forth, in respect of the foreign corporation, such
6 information as the Secretary or his delegate prescribes by
7 forms or regulations as necessary for carrying out the pro-
8 visions of the income tax laws.

9 “(c) OWNERSHIP OF STOCK.—For purposes of subsec-
10 tion (a) (2) and (3), stock owned directly or indirectly by
11 a person (including, in the case of an individual, stock owned
12 by members of his family) shall be taken into account. For
13 purposes of the preceding sentence, the family of an indi-
14 vidual shall be considered as including only his brothers
15 and sisters (whether by the whole or half blood), spouse,
16 ancestors, and lineal descendants.

17 “(d) TIME FOR FILING.—Any return required by sub-
18 section (a) shall be filed on or before the 90th day after
19 the day on which, under any provision of subsection (a), the
20 United States citizen, resident, or person becomes liable to
21 file such return.

22 “(e) CROSS REFERENCE.—

 “**For provisions relating to penalties for violations of
 this section, see sections 6678 and 7203.**”

1 (c) CIVIL PENALTY FOR FAILURE TO FILE RETURN.—

2 Subchapter B of chapter 68 (relating to assessable penal-
3 ties) is amended by adding at the end thereof the following
4 new section:

5 “SEC. 6678. FAILURE TO FILE RETURNS AS TO ORGANIZA-
6 TION OR REORGANIZATION OF FOREIGN
7 CORPORATIONS AND AS TO ACQUISITIONS
8 OF THEIR STOCK.

9 “(a) CIVIL PENALTY.—In addition to any criminal
10 penalty provided by law, any person required to file a return
11 under section 6046 who fails to file such return at the time
12 provided in such section, or who files a return which does
13 not show the information required pursuant to such section,
14 shall pay a penalty of \$1,000, unless it is shown that such
15 failure is due to reasonable cause.

16 “(b) DEFICIENCY PROCEDURES NOT TO APPLY.—Sub-
17 chapter B of chapter 63 (relating to deficiency procedure
18 for income, estate, and gift taxes) shall not apply in respect
19 of the assessment or collection of any penalty imposed by
20 subsection (a).”

21 (d) TECHNICAL AMENDMENTS.—

22 (1) Section 318(b) (relating to cross references)

23 is amended by striking out “and” at the end of paragraph

(5), by striking out the period at the end of paragraph (6) and inserting in lieu thereof “; and”, and by adding at the end thereof the following:

“(7) section 6038(d)(2) (relating to information with respect to certain foreign corporations).”

(2) The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by striking out

“Sec. 6046. Returns as to creation or organization, or reorganization, of foreign corporations.”

and inserting in lieu thereof

“Sec. 6046. Returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock.”

(3) The table of sections for subchapter B of chapter 68 is amended by adding at the end thereof the following:

“Sec. 6678. Failure to file returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock.”

(e) EFFECTIVE DATE.—

(1) The amendments made by subsection (a) shall apply with respect to annual accounting periods of foreign corporations beginning after December 31, 1962.

(2) The amendments made by subsection (b) shall take effect on January 1, 1963.

1 **SEC. 21. TREATIES.**

2 Section 7852 (d) of the Internal Revenue Code of 1954
3 (relating to treaty obligations) shall not apply in respect of
4 any amendment made by this Act.

Passed the House of Representatives March 29, 1962.

Attest:

RALPH R. ROBERTS,

Clerk.

87TH CONGRESS
2D Session

H. R. 10650

AN ACT

To amend the Internal Revenue Code of 1954 to provide a credit for investment in certain depreciable property, to eliminate certain defects and inequities, and for other purposes.

APRIL 2, 1962

Read twice and referred to the Committee on Finance

12. PUBLIC ASSISTANCE; MEDICAL CARE. Continued debate on H. R. 10606, to extend and improve the public assistance and child welfare service programs of the Social Security Act, and the proposed amendment to the bill by Sen. Anderson to provide a program of medical care for the aged. pp. 12449-52, 12456-78
13. TAXATION. Sen. Kerr submitted an amendment to H. R. 10650, the proposed Revenue Act of 1962, which he explained as eliminating from coverage under section 13 those foreign corporations which promote the export of products manufactured, produced, grown or extracted in the U. S. He stated that, in the case of certain agricultural products, a 50-percent requirement is substituted for the 75-percent requirement. pp. 12398-9
14. FOREIGN AGRICULTURE. Sen. Javits stated that "communism's greatest defeat lies in the field of agriculture and its greatest failure is in Communist China," and inserted an article, "The Faminemakers--A Report On Why China Is Starving."
15. LAND-GRANT COLLEGES. Sen. Gruening discussed the extension of educational program of the University of Alaska. pp. 12422-3
Sen. Mansfield commended the 100th anniversary celebration of land-grant colleges. pp. 12482-3
16. FOREIGN AFFAIRS; LOBBYING. Agreed to without amendment S. Res. 362, to authorize a study of the nondiplomatic activities of foreign governments. pp. 12480-1
17. INTERGOVERNMENTAL RELATIONS. Agreed to without amendment S. Res. 359, authorizing the creation of a Subcommittee on Intergovernmental Relations. pp. 12481-2
18. MONOPOLIES. The Judiciary Committee ordered reported (but did not actually report) with amendment (in the nature of a substitute) S. 1552, the proposed Drug Industry Antitrust Act. p. D578
Sen. Kefauver inserted a speech by the head of the antitrust division of the Justice Department on the operation of antitrust laws which he described as an "exceptionally splendid" presentation. pp. 12417-20

ITEMS IN APPENDIX

19. FOREST PRODUCTS. Extension of remarks of Sen. Neuberger inserting two editorials in support of modification of the Jones Act. pp. A5294-5
20. DAIRY PRODUCTS. Extension of remarks of Rep. Harvey inserting a Wall Street Journal editorial criticizing the milk marketing quotas program. p. A5296
21. FOREIGN TRADE. Extensions of remarks of Senators and Representatives favoring and opposing the proposed Trade Expansion Act. pp. A5298, A5301-3, A5303-4.
22. FOREIGN AID. Extension of remarks of Rep. Jensen urging the reform of social inequities in countries receiving U.S. aid. p. A5309
Extension of remarks of Rep. Blatnik inserting articles supporting continued aid to Poland and Yugoslavia, pp. A5323-4
23. ELECTRIFICATION. Extension of remarks of Sen. Neuberger inserting an article praising the work of REA in Agness, Oregon. p. A5300.
Extension of remarks of Sen. Douglas inserting an address which discusses monopoly practices of some large electrical companies. pp. A5306-7
24. EDUCATION. Extension of remarks of Rep. Bailey supporting the current House and Senate bills to promote general extension education. pp. A5316-17

Extension of remarks of Rep. Morrow commemorating the 100th anniversary of the Morrill Land-Grant College Act. pp. A5324-5

25. FOREIGN AGRICULTURE. Extension of remarks of Rep. Conte inserting an address which discusses the economy of South Africa. pp. A5320-1
26. FARM PROGRAM. Extension of remarks of Rep. Thompson discussing his own record in the House and inserting letters from his constituents which express their views on the farm program. pp. A5326-36

BILLS INTRODUCED

27. RECLAMATION. H. R. 124493, by Rep. Breeding to amend section 9(d) (1) of the Reclamation Project Act of 1939 (53 Stat. 1187; 43 U.S.C. 485), to make additional provisions for irrigation blocks; to Interior and Insular Affairs Com.
28. AREA REDEVELOPMENT. H. R. 12494, by Rep. Cramer, to authorize assistance under the Area Redevelopment Act in the case of any area which has been adversely affected by the imposition of the United States of an embargo on the importation of products from Communist or Communist-dominated countries; to Banking and Currency Committee.
29. CONTRACTS. H. R. 12507, by Rep. Giaimo, to prohibit the letting of contracts for professional services through competitive bidding; to Government Operations Committee.
30. PATENTS. H. R. 12513, by Rep. Willis, to provide for public notice of settlements in patent interferences; to Judiciary Committee.
31. HOLIDAY. H.J. Res. 817, by Rep. Mosher (by request), providing that the day on which the presidential election is held shall be a legal holiday; to Judiciary Committee.

PRINTED HEARINGS RECEIVED IN THIS OFFICE

32. ELECTRIFICATION. H. R. 6951 and S. 1606, exemption of small hydroelectric power projects. H. Interstate and Foreign Commerce Committee.
33. PERSONNEL. H. R. 3258, and other bills, to provide retirement credit for Federal State employees; employee organization health plans; and survivors' annuities. H. Post Office and Civil Service Committee
34. APPROPRIATIONS. Dept. of State, Justice, Commerce, Judiciary, and related agencies appropriations for 1963. (This part includes USIA, Small Business Administration and other related agencies). H. Appropriations Committee.

COMMITTEE PRINT RECEIVED IN THIS OFFICE

35. ECONOMICS. "Inventory Fluctuations and Economic Stabilization", part 4, supplementing previous papers dealing with inventory movements and economic instability, and presenting the results of a survey of the inventory policies and practices of a sample of manufacturing companies, together with the results of a study of an econometric model of the economy wherein inventory fluctuations are assumed to be at or near a minimum. Jt. Economic Committee.

gree of finality to the settlement of jurisdictional strikes in the airline industry. In entirely too many cases, we have seen the Nation's vast airline industry paralyzed by a jurisdictional strike or walkout involving the Air Line Pilots Association and the flight engineers.

This type of strike, which so adversely affects our national air transport system, and renders unemployed tens of thousands of other airline workers who have no dispute at all with the airlines, is not a strike by workers against management. It is a strike of one union against another.

It is not a genuine strike over wages or working conditions. It is a strike over which union will handle which job in the operation of the aircraft.

Management is powerless to settle this kind of jurisdictional strike. If it holds in favor the engineers, the pilots walk out; or if it holds in favor of the pilots, the engineers walk out.

Over the horizon, there is a strike threatening Pan American, our big international airline, with 17,000 employees to be affected. Down the road is the strike being threatened against American, affecting 23,000 employees. All those employees are threatened with idleness by this small group which insists on a backward interpretation of the old prop-driven, reciprocating motor days. The National Mediation Board, after hearings, determined that the duties of flight engineer and pilot on jet aircraft did not differ to such an extent to entitle them to representation as a separate craft. This determination was sustained by the courts. Threat of an industrywide strike over this decision brought a new study by a presidential commission headed by Professor Feinsinger. Again merger was recommended. But the flight engineers persisted. On June 16, they decided to strike, but withheld the information as to what lines and when, later announcing it would be Trans World Airlines.

After the Trans World strike threat, and after weeks of bargaining, in which the Secretary of Labor and representatives of management and the engineers met, they agreed on the engineers' right in the cockpits and a proper representation in the merger of the unions if they saw fit to merge.

It is about time that the Congress passed some law that would enable the public, the airlines, and the workers to have some kind of relief against willful men who think of nothing except the interest of a small group of union czars sitting in Idlewild telling the employees of the airlines of the Nation that they can be unemployed while they fight over vanity and the preservation of a monopoly over a certain type of job that no longer requires the skill that once was required.

Mr. RANDOLPH. Mr. President, will the Senator yield?

Mr. MONRONEY. I yield.

Mr. RANDOLPH. Mr. President, the Senator from Oklahoma states the seriousness of this problem. It is not a problem of tomorrow, but of today. As

a fact, it is a problem of yesterday. It is a matter which the Federal Government must consider as an imperative challenge. Congress, certainly the Senate cannot delay longer its attention to this impairment of an essential portion of our air transport system.

I shall not go into a repetition of the lucid language by my colleague, the Senator from Oklahoma, because he has well set forth the situation, but I do indicate that in the State of West Virginia this is a matter which goes deeper than a disruption of needed airline service. It is a condition which results in serious deterrent of the growth of the State and the wellbeing of our citizens. The strike is not only a stoppage of planes but it adversely affects business. In connection with the operation of flights of Eastern Air Lines at the Kanawha Airport at Charleston and the Tri-State Airport in Huntington, we are cognizant of the breakdown of bargaining which keeps the aircraft grounded. The people of West Virginia who depend upon the services of this scheduled carrier realize the ill effects. Our people are alarmed. Telegrams of protest to me are evidence of the widespread discontent.

For the record, I will indicate that in 1961, in Charleston and Huntington, Eastern handled 124,228 passengers. In that year this carrier originated in those two areas of West Virginia 568,014 pounds of cargo.

I am in earnest in these vigorous remarks. I join in support of the proposal; and I remember that not many days ago in this forum I joined my colleagues, the Senator from Oregon [Mr. MORSE] and the Senator from Oklahoma [Mr. MONRONEY], in pledging that affirmative efforts would be formulated. This approach may not be the best device, but hearings should be held in the Labor and Public Welfare Committee, on which I serve, on the problem.

I am not critical of the delay in the introduction of legislation except to warn that this strike moves into its third week. It is, I repeat, a serious situation. I cosponsor this measure, believing that I act in a responsible manner in doing so.

Mr. HOLLAND. Mr. President, I congratulate warmly the Senator from Oklahoma. I have been waiting for a long time to hear vigorous words such as his from someone who is an authority in the field. The Senator from Oklahoma is the chairman of the subcommittee of the Senate which deals with the entire field of aviation. I hope that his words will be followed by early action of the Senate.

I have been moving in this direction for years now. I have pending on this subject S. 88, which might go a little further than is suggested in the bill offered by the Senator from Oklahoma. I shall not quibble about the distance to which the Senator would go. I wish to support the Senator in anything to bring relief.

What has been said by the distinguished Senator from West Virginia [Mr. RANDOLPH] could be multiplied many times in its application to the city of Miami and to the city of Hialeah, in

which several thousand employees and many thousands of travelers are affected by the current strike each day.

I hope the Senate will finally be aroused to take some action in this field. I have talked several times recently with the able Secretary of Labor. I had hoped he would come out for the administration with some suggestion, and I believe that is imminent.

I hope the Senate, without letting innocent people continue to suffer, will soon take action in this field.

Mr. JAVITS. Mr. President, New York has been seriously disrupted by the Eastern Air Lines strike, as have many other cities in the country. This does not mean, necessarily, we have to take action which may be unwise.

I agree with the Senator from Oklahoma, who graciously offered me the opportunity to join in sponsorship of his bill, that there is a serious problem, but I did not think it wise to join as a cosponsor, as a member of the Committee on Labor and Public Welfare.

The Senator has pointed out for all of us the real deficiency in the Railway Labor Act as well as in the National Labor Relations Act. In the final analysis one does not know what to do about major strikes which tie up major elements of the transportation system except to come to the Congress. Therefore, I wish to state advisedly, as a member of the Committee on Labor and Public Welfare, I shall consider it my duty to do everything I humanly can to get an immediate hearing on the bill. I agree that the Senate and the Congress must and should act in the national interest.

The Senator from Oklahoma has given us his proposal, his prescription. There may be others. Congress is charged with the responsibility of determining what is the best approach. The Congress is the final residual basis of authority. That we must act in a situation of this character I have no doubt.

I hope very much that other colleagues on the committee, including the Senator from West Virginia [Mr. RANDOLPH], will assist me in getting committee attention promptly directed to the problem.

MODIFICATION OF THE DEVILS SWAMP PROJECT ON THE MISSISSIPPI RIVER

Mr. LONG of Louisiana. Mr. President, I introduce, for appropriate reference, a bill to authorize a modification of the Mississippi River, Baton Rouge to the Gulf of Mexico, barge channel through Devils Swamp, La.

The purpose of this bill is to provide for the completion of the 5-mile barge canal known as the Devils Swamp project, and to add to the existing authorization, the construction of suitable dikes and other retaining structures, for the construction and future maintenance of the project, in order to provide additional industrial sites with water frontage which are now needed to permit the normal development and expansion of the industrial and commercial activities of the locality.

The bill that originally authorized this barge canal, provided for a canal 5 miles in length, but indicated that only half of this canal would be dug, and the second half would follow when the industrial development warranted it. The bill failed to state that necessary retaining dikes would be provided to prevent the spoil from returning to the river and that would make it possible for the banks of the river to be improved to an extent that they would attract the desired industrial development.

In spite of this inducement, the industrial development in this area is both obvious and imminent. It is time to build the second half of the project. However, it should be built in such a way that this development should be encouraged rather than retarded.

The cost of constructing retaining dikes is insignificant when compared with the benefits that will be accrued from the project. Further, as inducement to the Federal Government, local interests matched the Federal Government 50-50 on the cost of the first half of the project. No such matching funds should be required for the second half of the project, and what has already been contributed should be considered as more than adequate to cover a fair contribution toward the land enhancement that will accrue from the judicious disposal of the material that is removed from the river in connection with the construction of the channel.

I move the earliest possible completion of this needed project and hope that it will be included in the omnibus public works authorization bill that I feel certain will be approved by this Congress.

The VICE PRESIDENT. The bill will be received and appropriately referred.

The bill (S. 3541) authorizing the modification of the Mississippi River, Baton Rouge to the Gulf of Mexico, barge channel through Devils Swamp, La. (Baton Rouge Harbor), introduced by Mr. Long of Louisiana, was received, read twice by its title, and referred to the Committee on Public Works.

REVENUE ACT OF 1962— AMENDMENT

Mr. KERR. Mr. President, I submit an amendment to section 13 of H.R. 10650 which is in addition to the amendment which I submitted on July 10, 1962. I feel that this is a most important amendment because it eliminates from coverage under section 13 those foreign corporations which promote the export of products manufactured, produced, grown, or extracted in the United States. It also benefits those foreign subsidiaries which promote the licensing abroad of patents, secret processes, and other like property owned by U.S. companies. The foreign subsidiaries who would be eligible would be those having 75 percent or more of their income from export trade activities. To the extent that the profits from such export trade activities were reinvested in assets used in export trade business, deferral of U.S. tax will be continued. In the case of certain agricultural products, a 50-percent requirement is substituted for the 75-percent require-

ment. A detailed explanation of the amendment is as follows:

II. DETAILED EXPLANATION OF AMENDMENT

A. Definition of export trade corporation: An export trade corporation would be a controlled foreign corporation 90 percent or more of the gross income of which for a 3-year period immediately preceding the close of the taxable year was derived from sources without the United States and 75 percent or more of the gross income of which for such period constituted export trade income. The rule would be reduced to 50 percent in the case of export trade income derived in respect of agricultural products grown in the United States.

B. Definition of export trade income. Export trade income would consist of four categories described as follows:

First. Sale of U.S. exports: Income from the sale of U.S. exports together with various kinds of service income rendered in connection with the sale or in connection with the installation or maintenance of such property.

Second. Licensing of U.S. patents, and so forth: Income derived by the foreign corporation from the conduct of a foreign license and technical assistance program. Here, the foreign subsidiary would receive commissions, fees, and so forth, for negotiating and servicing license agreements between unrelated foreign users and U.S. companies which acquired or developed and owned certain patents, copyrights, secret processes, and so forth. It would be required that the U.S. company owning such intangible rights be the same company that manufactured or produced export property in respect of which the export trade corporation earns income under the preceding paragraph.

Third. Income from rentals and use of U.S. exports: The third category would consist of rentals or other income received from unrelated parties for the use of property manufactured in the United States—for example, rentals on equipment—and a related kind of income; namely, the income attributable to the use by the controlled foreign corporation of U.S.-manufactured property used in the rendition of services, and so forth, to an unrelated party. Under the latter category, if the controlled foreign corporation rendered services to an unrelated foreign person that part of the compensation received from the unrelated person which was attributable to the use of technical equipment manufactured in the United States would be treated as export trade income. Unless such income were readily ascertainable, it would be assumed that it was that part of the profit which the depreciation on the U.S. equipment bore to the total cost of earning the income.

Fourth. Interest income from financing of export income: The final category would consist of interest income received by the controlled foreign corporation on credit advanced by it to unrelated persons in connection with transactions giving rise to export trade income.

C. Definition of export trade assets: Export trade assets are the assets which are eligible for reinvestment out of the export trade profits of a controlled for-

eign corporation. These would be limited to, first, working capital reasonably necessary for the production of export trade income; second, inventory of U.S. export property; third, facilities located outside the United States for the storage, packaging, handling, transportation, or servicing of export property; or, fourth, evidences of indebtedness from unrelated persons in connection with payment for export trade income.

D. Definition of export trade expenses: The amount of profit of an export trade corporation eligible for reinvestment is limited to either 10 percent of its gross receipts or 1½ times its export trade promotion expenses, whichever is lesser. Export promotion expenses means ordinary and necessary expenses paid or incurred for the purpose of producing export trade income and include a reasonable allowance for salaries, rentals for property used in the export business, depreciation on property used in such business, and a reasonable allocation of all other ordinary and necessary expenses of the controlled foreign corporation allocable to the production of export trade income provided that at least 90 percent of each such category of expenses is incurred outside of the United States. If less than 90 percent of each such category is incurred outside the United States, then the amount of the profit eligible for reinvestment would actually be limited to 1½ times the amount incurred outside the United States.

E. Export property: Export property, the kind of property the sale or use of which gives rise to export trade income, is defined as any property or any interest in property manufactured, produced, grown, or extracted in the United States.

F. Treatment of export trade corporation: If a controlled foreign corporation qualifies as an export trade corporation, then, in lieu of the amount of subpart F income, it would normally be taxable on under section 951(a)(1)(A), it would be taxed only on the following amounts:

First. That part of its subpart F income which does not result from export trade income.

Second. That part of its subpart F income which exceeds either 10 percent of its gross receipts or 1½ times its trade promotion expenses. It is expected that in many cases the 10-percent limitation will serve as reasonable assurance that intercompany pricing has been proper. In such cases the application of section 482 would be unnecessary.

Third. That part of its subpart F income which is within the 10-percent or 1½-times rule, but which is not reinvested in export trade assets. Investment in export trade assets means the annual increase in such assets so that in order to obtain deferral with respect to such export trade income, the controlled foreign corporation must continue to grow and continue to expand its investment in inventory, credit extension, foreign warehouses, and so forth. If in any year there was actually a net decrease in the amount of such investments, the net decrease would in such year constitute income which would be taxed to the U.S. shareholders.

G. Consolidation: Provision is made for several controlled foreign corpora-

tions which are in a single chain of ownership to be consolidated for purposes of meeting the requirements and gaining the benefits of the amendment. The chain of controlled foreign corporations eligible for consolidation would consist of a single controlled foreign corporation and its 80 percent owned subsidiaries and sub-subsidiaries. Each company in the chain has to qualify as an export trade corporation.

The VICE PRESIDENT. The amendment will be received, printed, and referred to the Committee on Finance.

**TO PRINT AS A SENATE DOCUMENT
THE CONFERENCE REPORT ON
H.R. 11131, TO AUTHORIZE CER-
TAIN CONSTRUCTION AT MILI-
TARY INSTALLATIONS (S. DOC.
NO. 107)**

Mr. MANSFIELD. Mr. President, on behalf of the Senator from Washington [Mr. JACKSON], I submit a report of the committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 11131) to authorize certain construction at military installations. I ask unanimous consent that the report be printed as a Senate document.

The VICE PRESIDENT. Is there objection? The Chair hears none, and it is so ordered.

**NOTICE OF HEARING ON NOMINA-
TION OF NOEL P. FOX TO BE U.S.
DISTRICT JUDGE, WESTERN DIS-
TRICT OF MICHIGAN**

Mr. HART. Mr. President, on behalf of the Committee on the Judiciary, I desire to give notice that a public hearing has been scheduled for Thursday, July 19, 1962, at 10:30 a.m., in room 2228 New Senate Office Building, on the nomination of Noel P. Fox, of Michigan, to be U.S. district judge, western district of Michigan, vice Raymond W. Starr, retired.

At the indicated time and place persons interested in the hearing may make such representations as may be pertinent.

The subcommittee consists of the Senator from Missouri [Mr. LONG], the Senator from Nebraska [Mr. HRUSKA], and myself, as chairman.

**ADDRESSES, EDITORIALS, ARTI-
CLES, ETC., PRINTED IN THE AP-
PENDIX**

On request, and by unanimous consent, addresses, editorials, articles, etc., were ordered to be printed in the Appendix, as follows:

By Mr. COTTON:

Remarks made by Senator BUSH on the "Dana Clark Show."

By Mr. ANDERSON:

Address delivered by Nitish C. Laharry, of Calcutta, India, president of Rotary International, at 50th anniversary meeting of the Rotary Club of Washington, D.C., on July 11, 1962.

By Mr. DOUGLAS:

Address entitled "The Great Price Conspiracy," delivered by John Herling, before the annual dinner of the Washington, D.C. Book Sellers Association.

Letter dated June 22, 1962, from President Kennedy to John D. Pemberton, Jr., executive director, American Civil Liberties Union, conveying best wishes for the biennial conference of the American Civil Liberties Union.

News broadcast by Edward P. Morgan on July 5, 1962.

By Mr. CASE:

Statement concerning copyrighting of contents of Government publications and documents, published in the New York Times of July 9, 1962.

By Mrs. NEUBERGER:

Article entitled "Agness, Oreg., Is Electrified," published in the July 1962 issue of Rural Electrification.

Sundry editorials dealing with importation of lumber from Canada.

By Mr. WILEY:

Article entitled "International Trade Is One of America's Most Important Businesses," published in Department of Commerce publication International Commerce.

Article entitled "General Federation Prepares for 1963," published in the Milwaukee Journal on July 2, 1962.

By Mr. WILLIAMS of New Jersey:

Article entitled "Unionists Aid Orphans by Free Labor," published in the AFL-CIO News, Washington, D.C., on July 7, 1962.

Article entitled "Red Slur Jars New Jersey Students," published in the Newark (N.J.) Evening News on July 3, 1962.

Editorial entitled "Mr. Kennedy Looks to Distant Day" published in the Daily Journal, Elizabeth, N.J., on July 6, 1962; and editorial entitled "Interdependence Makes Appealing Rallying Cry," published in the Asbury Park (N.J.) Evening Press on July 9, 1962.

By Mr. HRUSKA:

Editorial entitled "Increasing Costs," published in the Norfolk Daily News of July 2, 1962.

**THE 100TH ANNIVERSARY OF ARMY
MEDAL OF HONOR**

Mr. SALTONSTALL. Mr. President, I am reminded today of a statement made by President Eisenhower as he bestowed the Army's Medal of Honor on a young hero of the Korean war. In words which expressed the sentiments of the Nation, and indicated his personal esteem of our Nation's highest award for gallantry in action, the President said:

Son, I would rather have the right to wear this than be President of the United States.

- This story comes to mind, Mr. President, for today is the 100th anniversary of the authorization of the Army's Medal of Honor. It was on this date, a century ago, that President Lincoln signed a congressional resolution which provided for the preparation of Medals of Honor to be presented "to such noncommissioned officers and privates as shall most distinguish themselves by their gallantry in action, and other such soldierlike qualities."

The law was amended, in 1863, to apply to officers, as well.

Over the years, the Medal of Honor has come to be much more than a handsome, five-pointed star, laurel wreathed in green enamel, and held by a white starred ribbon of blue silk. It is a token of national esteem. It is the ultimate symbol of our national gratitude.

The Army's Medal of Honor, epitomizing valor and heroic action, stands at the apex of a pyramid of honor. This pyramid, created by precedent and pro-

cedure, is built in recognition of the various degrees of courage and service to the Nation. All deeds of honor in combat deserve recognition; but only those of truly extraordinary personal bravery which clearly lifts the individual far above his comrades are worthy of our Nation's highest award.

The soldiers who have won the Medal of Honor are the flower of our American manhood—strong, hardy, full of the vigor, courage, and idealism of our Nation. They come from cities, towns, villages, and farms throughout the United States. They represent every rank, from private to general. They are soldiers who wrote in the tumultuous tide of war truly magnificent pages in the history of freemen.

Each one knew of the enormity of the sacrifice his Nation was calling upon him to make, for when men have been long in battle and have thought deeply about their situation, there comes at last the awareness of ultimate responsibility—the realization that one must go ahead, that a nation may live.

Today, a grateful nation is honoring these men. Some of them are still compiling distinguished records in our Nation's Armed Forces. Others have returned to civilian life. And many lie beneath the lands and seas of all the continents. But our memory of them and of their deeds is still sharp and clear in our minds.

The winners of the Medal of Honor purchased our legacy of freedom with their deeds. It is now our duty to preserve that legacy, enhance it if possible, and then transfer it safely to the next generation.

In preparing ourselves to live up to our responsibilities as the champion of freedom for the free world, we should reflect on the heroic example of the winners of our Nation's Medal of Honor. Inspired by their example, we can renew our strength to meet successfully the challenges which lie before us, as we work together for the cause of peace with honor.

Mr. CASE. Mr. President, on the occasion of the 100th anniversary of the signing by Abraham Lincoln of the law establishing the Congressional Medal of Honor, I congratulate the 14 New Jersey residents who have received the Nation's highest award for valor.

New Jersey is honored to have among its residents men who have been recognized for courage and valor in defending our Nation.

Luther Skaggs, president of the Congressional Medal of Honor Society, an organization chartered by the Congress, has informed me that New Jersey has one of the largest numbers of members in his society. This society has as its goal "to protect, uphold, and preserve the dignity of the medal and its individual holders."

In a statement prepared by Mr. Skaggs he pays particular tribute to Benjamin Kaufman, 925 Bellevue Avenue, Trenton, N.J. Mr. Kaufman, former national commander of the Jewish War Veterans, won his Congressional Medal of Honor during World War I. At that time a first sergeant, Kaufman was leading an infantry patrol in the Argonne Forest,

France, in October 1918, when a burst of machinegun fire shattered his right arm. Hurling grenades with his left hand and brandishing an empty pistol in his useless right hand, he made a one-man charge on the enemy machinegun nest, capturing a prisoner and scattering the rest of the crew. He brought the machinegun, his prisoner, and his empty pistol back to the American lines under intense enemy fire.

The other Congressional Medal of Honor winners from my State are: Stephen R. Gregg, 130 Lexington Avenue, Bayonne, N.J.; Hector A. Cafferata, Crestwood Drive, R.F.D. 1, Dover, N.J.; Francis X. Burke, 132 Kensington Avenue, Jersey City, N.J.; Capt. Carlton R. Rouh, 414 Chestnut Avenue, Lindenwold, N.J.; John W. Meagher, 22 Cliff Street, Jersey City, N.J.; Samuel M. Sampler, 434-B Whitman Drive, Haddonfield, N.J.; Franklin E. Sigler, Long Hill Road, Little Falls, N.J.; Allan L. Eggers, Sand Spring Road, Morristown, N.J.; Capt. Freeman V. Horner, 2 Hensing Drive, Mount Holly, N.J.; Nicholas Oresko, 31 Benjamin Road, Tenafly, N.J.; Frank J. Bart, 1100 West Street, Union City, N.J.; Carl Emil Petersen, 427 Hyatt Street, Avenel, N.J.; and William A. Shomo, 107 Crescent Avenue, Waldwick, N.J.

As a Senator from New Jersey, I join with the residents of all States in honoring these men who have been recognized for deeds of courage performed on the field of battle. We shall always appreciate their great contribution toward preserving our Nation.

COOPERATION OF GOVERNMENT AND PRIVATE ENTERPRISE IN SUCCESSFUL ORBITING OF TELSTAR SATELLITE

Mrs. SMITH of Maine. Mr. President, the brilliant success of the Telstar communications satellite on Tuesday of this week gave me one of the emotional highlights of my life.

It was my privilege to be present at the ceremony and to view the closed circuit coverage of this historic event.

When the Vice President of the United States and the chairman of the board of the American Telephone & Telegraph Co. talked with each other by telephone through the Telstar that was 3,000 miles above the earth, I was extremely proud that I had once been a member of the telephone company.

My thoughts flashed back many years ago to those nights when I was a switchboard operator in my hometown of Skowhegan—of how I made connections for the callers in Skowhegan. Now I was watching Telstar make connections not only between Andover, Maine, and Washington, D.C., but across the Atlantic Ocean between the United States and France and Britain.

Yes, there was a great thrill in my pride that I had been an employee of the company that had made this remarkable achievement. The sound of success Tuesday night over the satellite communications system of the telephone company was like the time when, as the

switchboard operator in Skowhegan, I first heard the beautiful voice of the man I was later to marry.

And I had great pride in the fact that the key point of this tremendous operation was in my home State of Maine at Andover.

But the deepest feeling that I had was as a member of the Senate Committee on Aeronautical and Space Sciences and the faith that I had that freemen and private industry could work in full cooperation with the Government. Others have not had that faith.

Tuesday night my faith was fully vindicated, for it was the great teamwork between the Government and private industry that produced the magnificent achievement—that proved the superiority of freedom and free enterprise over the Communist system of slaves and enslavement in which the government controls all.

Tuesday night brought complete vindication to the faith I had in private enterprise and to the support that I had given in committee on legislation to give private enterprise its proper role in this wondrous space exploration program.

DEATH OF COUNCILMAN STANLEY ISAACS

Mr. JAVITS. Mr. President, I have the sad duty of announcing to the Senate the passing from this earth and our life of a very, very distinguished New Yorker, and a very close friend of mine, Councilman Stanley Isaacs, who was almost as synonymous with New York City as is City Hall and the Mayor of New York. He passed away last night, but the newspapers have not yet carried the news. Radio and television have.

It is with great sadness that I announce this news to the Senate. I think the distinction and eminence of my close friend and fellow New Yorker was of such a character as to deserve mention here on the floor of the Senate.

Stanley Isaacs was not only one of our most luminous citizens, but he carried in his heart as he did in his mind a deep feeling and love for the people of New York and for New York as a great metropolitan example of communal living which was unique in our time.

He served us for a great part of his life. He was deeply beloved by New Yorkers of all ranks, stations, and parties. He was a one-man minority and a one-man conscience for the people of New York, and he lived a very honored life.

He came under fire and attack from time to time, but always realized the affection and trust of his fellow citizens, and won their confirmation, which is the pride of every American.

So I extend my deepest sympathy to Mrs. Isaacs, who is also a close friend of mine and my wife's. I know I express the feeling of many, many Americans, and certainly of every New Yorker, in mourning the loss of a man who could be described as our No. 1 New Yorker—other than our mayor—Councilman Stanley Isaacs.

Mr. President, I ask unanimous con-

sent to include in the RECORD as a part of my remarks the biography of Councilman Isaacs from "Who's Who."

There being no objection, the biography was ordered to be printed in the RECORD, as follows:

Isaacs, Stanley Myer, United States, attorney, public official; born New York City, September 27, 1882; son Myer S. and Maria (Solomon); B.A., Columbia University, 1903, M.A. 1904; L.L.B., New York Law School, 1905; married Edith Somborn, May 18, 1910; children: Myron S., Mrs. Helen Herrick. Associated with law firm, M. S. & I. Isaacs, since 1942, member of firm, 1905-19; associated with real estate, building and investments, 1919-38. Member, city council, New York, since 1941. Republican minority leader since 1949; president, Borough of Manhattan, 1938-41; chairman, local draft board No. 164; consultant on labor problems, Office of Secretary of War, World War I; member, advisory commission, New York State Conference on Social Work, president, 1944; executive board, New York State Commission on Discrimination in Housing. President, United Neighborhood Houses, since 1932; member, board of directors, Citizen's Housing and Planning Council, New York; board of trustees, Roosevelt Memorial Association; advisory commission, National Council on Naturalization and Citizenship; Citizen's Commission on Children; United Service for New Americans; New York Fund for Children, Inc.; advisory board, Play School Association; New York Division, American Friends of Hebrew University; college commission, Public Education Association; trustee at large, Federation of Jewish Philanthropies of New York; State board, New York Chapter, Americans for Democratic Action; board of directors, Institute of Practical Politics, 1952; vice president: United Jewish Appeal, Greater New York; Baron de Hirsch Fund; honorary trustee: Ednl Alliance, president, 1933-37; James Weldon Johnson Community Center; trustee, West End Synagogue; treasurer, Dalton Schools, Inc.; member, advisory board, Wiltwyck School for Boys. Recipient, awards: Brooklyn Philanthropic League, for activities on behalf of Settlement House, 1938; Fine Arts Federation for distinguished service to the fine arts, 1941; City-Wide Tenants Council, for meritorious housing service, 1941; Felix M. Warburg Memorial Award, Federation of Jewish Philanthropies, for 25 years' service, 1948; citation, United Neighborhood Houses, for 50 years' service in settlement movement, 1951; award, New York Young Republican Club, for civic service, 1953. Clubs: Republican City; City Athletic; Yorkville Neighborhood; The Judeans. Home: 14 East 96th Street, New York, N.Y. Office: 475 Fifth Avenue, New York, N.Y.

Mr. KEATING. Mr. President, the tragic death of Stanley Isaacs, member of the New York City Council, and a beloved figure to all who knew him, will be an irreparable loss to the people of New York.

He was for many years the only Republican member of the city council, in which capacity he served all the citizens of that city, without regard to party affiliation. He spoke for all the people, regardless of race, religion, and nationality. He stood for honesty and integrity in government.

Mr. President, his death will be a great loss to the great city of New York. His shoes will not be easily filled, for he was a man with breadth of wisdom and honesty of judgment in all his public and private dealings. He did not look for the limelight, but where he saw neglect, in-

Digest of CONGRESSIONAL PROCEEDINGS

OF INTEREST TO THE DEPARTMENT OF AGRICULTURE

OFFICE OF
BUDGET AND FINANCE

(For information only;
should not be quoted
or cited)

Issued July 23, 1962
For actions of July 20, 1962
87th-2d, No. 124

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HIGHLIGHTS: House committee reported agriculture appropriation bill. House received conference report on second supplemental appropriation bill. Sen. Williams, Del., charged there was shortage of grain in Estes warehouses. Sen. Curtis criticized handling of Estes case. Sen. Keating charged USDA plays politics in drought relief assistance. Sen. Robertson urged elimination of 55 million national wheat acreage allotment. Senate agreed to conference report on foreign aid authorization bill. Senate passed Labor-HEW appropriation bill. Rep. Michel criticized REA. House received conference report on foreign aid authorization bill. Rep. Henderson introduced and discussed bill to compensate Flue-cured tobacco farmers for natural disaster losses.

SENATE

1. **FARM PROGRAM.** Sen. Williams, Del., charged that there was a shortage of over 68,000 bushels of grain stored in Estes warehouses and inserted several items relating to this matter. pp. 13310-15

Sen. Curtis charged that the Estes cotton allotment transfers "were clearly illegal and fraudulent," and inserted recent testimony by Walter J. Arnote regarding the transfers. pp. 13362-5

Sen. Keating criticized the announcement made by the Democratic candidate for Governor of N. Y. that this Department was making drought relief assistance available to farmers in N. Y., and charged that the Department had been evasive to his request for such assistance. pp. 13315-6

Sen. Robertson urged that the farm bill be amended to eliminate the 55 million national wheat acreage allotment and to give the Secretary discretionary authority to reduce wheat acreage. p. 13294

Received the farm bill, H. R. 12391, as passed by the House. Sen. Dirksen objected to the second reading of the bill. p. 13303

2. FOREIGN AID. By a vote of 56 to 27, agreed to the conference report on S. 2996, the foreign aid authorization bill. pp. 13280, 13293-300, 13302-5

3. LABOR-HEW APPROPRIATION BILL, 1963. Passed with amendments this bill, H. R. 10904. Conferees were appointed. pp. 13305, 13316-59

Rejected the following amendments:

By Sen. Proxmire, 24 to 59, to reduce the amounts in the bill by \$247,105,000 which he stated was the level requested by the Administration. pp. 13316-23

By Sen. Dirksen, 33 to 39, to provide that none of the funds shall be used to increase employment above the level of June 30, 1962. pp. 13346-8

By Sen. Cooper, 30 to 43, to provide that each appropriation in the bill, with certain exceptions, shall be reduced by 5 percent. pp. 13355-8

4. INSECTICIDES; PESTICIDES. Sen. Proxmire expressed concern over the "alarming situation involving the excessive use of powerful pesticides," and inserted an article discussing the situation. pp. 13280-1

5. FARM LABOR. Sen. Hayden criticized the proposed "210-day, 35 week limitation on employment of Mexican nationals on farms," and inserted several items discussing the proposed limitation. pp. 13359-61

6. SAMOA. Conferees were appointed on H. R. 10062, to extend the application of certain laws to American Samoa. House conferees have already been appointed. p. 13293

7. PERSONNEL. H. R. 6374, to clarify the application of the Government Employees Training Act with respect to payment of expenses of attendance of Government employees at certain meetings, was made the unfinished business. p. 13361

8. WATERSHEDS. The Public Works Committee approved the following watershed projects: Hurricane Creek, Ala.; Town Creek, Ala.; Marbury Creek, Ga.; Middle Fork Broad River, Ga.; Upper Blue River, Okla.; and Thicketty Creek, S. C. p. D615

9. NOMINATIONS. Confirmed the nomination of Anthony J. Celebrezze to be Secretary of HEW. p. 13277

The Banking and Currency Committee reported the nomination of H. Gardiner Ackley to be a member of the Council of Economic Advisers. p. 13277

10. FLOOD CONTROL. The Banking and Currency Committee reported with amendment S. 3066, to authorize a study of methods of helping to provide financial assistance to victims of flood disasters (S. Rept. 1747). p. 13278

11. ELECTRIFICATION. The Interior and Insular Affairs Committee reported with amendment S. 3153, to guarantee electric consumers in the Pacific Northeast first call on electric energy generated in Federal plants in that region and to guarantee electric consumers in other regions reciprocal priority (S. Rept. 1748). p. 13278

12. TAXATION. Sen. Byrd, Va., inserted an announcement of the Finance Committee of action taken by the Committee on H. R. 10650, the proposed Revenue Act of 1962. With respect to tax treatment of cooperatives and patrons the announcement contains the following statement: "The committee tentatively agreed to require that in order for a cooperative to receive a deduction for qualified script, at least 20 percent of the value of the patronage dividend (including qualified script) must be paid in cash. The staffs were instructed to review the consent

provisions of the bill and report to the committee whether additional amendments should be made". pp. 13290-1

13. ADJOURNED until Mon., July 23. p. 13365

HOUSE

14. AGRICULTURAL APPROPRIATION BILL, 1963. The Appropriations Committee reported this bill, H. R. 12648 (H. Rept. 2024) (p. 13434). Attached to this Digest is a copy of the Committee report, at the end of which is included a summary table reflecting committee action on the bill.

15. SECOND SUPPLEMENTAL APPROPRIATIONS. Received the conference report on H. R. 11038, the second supplemental appropriation bill for 1962 (H. Rept. 2025) (pp. 13409-10, 13434). The report provides \$2,750,000 for the screwworm eradication program for the Agricultural Research Service. Direct Loan Account, Farmers Home Administration reported in disagreement. The report includes the following paragraph:

"The conferees hope that since the bill was passed by both bodies the fiscal year has ended and some items are no longer necessary. The managers on the part of the House will propose a concurrent resolution to change the engrossed House bill to eliminate those items which are now found unnecessary due to the lapse of time."

16. DEFENSE APPROPRIATIONS. Conferees were appointed on H. R. 11289, the Department of Defense appropriation bill. Senate conferees have already been appointed. p. 13367

17. STATE DEPARTMENT APPROPRIATIONS. By a vote of 266 to 114, passed with amendment H. R. 12580, making appropriations for the Departments of State, Justice, and Commerce, the judiciary, and related agencies for 1963. pp. 13375-409

18. FOREIGN AID. Received the conference report on S. 2996, the proposed Foreign Assistance Act of 1962 (H. Rept. 2008). pp. 13368-74, 13434

19. WHEAT. Received from this Department a proposed bill to extend the International Wheat Agreement Act of 1949; to Banking and Currency Committee. p. 13433

20. FARM PROGRAM. Rep. Stratton discussed his amendment to the farm bill with regard to compensatory payments on milk-marketing orders which was rejected on a point of order during debate on the farm bill, and criticized the ruling of the chair. p. 13412

21. ELECTRIFICATION. Representatives Michel, Collier, and Slack criticized REA loan policies. pp. 13422-7

22. FARM LABOR. Rep. Cooley inserted a letter from several members of the Agriculture Committee to Secretary Goldberg criticizing a recent ruling by the Labor Department with regard to a limitation on the employment of Mexican farm contract workers, pp. 13432

23. LEGISLATIVE PROGRAM. Rep. Albert announced the following legislative program: Mon., the conference report on H. R. 11038, the second supplemental appropriation bill; Tues., H. R. 12648, Department of Agriculture appropriations, and the conference report on S. 2996, the proposed Foreign Assistance Act of 1962. pp. 13410-1

24. ADJOURNED Until Mon., July 23. p. 13433

ITEMS IN APPENDIX

25. FARM PROGRAM. Speech of Rep. Udall during debate in the House commending Secretary Freeman and explaining why he voted against the proposed Food and Agriculture Act of 1962, pp. A5580-1
26. FOREIGN AID. Extension of remarks of Rep. Ashbrook decrying the ungratefulness with which foreign countries receive American aid. p. A5581
Extension of remarks of Rep. Keith inserting an editorial criticizing the foreign aid program. pp. A5588
27. FOREIGN TRADE. Extension of remarks of Sen. Mundt inserting an article which analyzes the effect of the Common Market on American agricultural exports. p. A5587
Extension of remarks of Sen. Hartke inserting an article which discusses the Soviet fear of the Common Market. pp. A5593-5
28. LAND-GRANT COLLEGES. Extension of remarks of Rep. Olsen inserting an article commending the achievements of the Creston Agriculture Experiment Station, Montana. pp. A5592-3.
29. PERSONNEL. Extension of remarks of Rep. Multer inserting his statement supporting Federal employee salary increases. pp. A5620-1
30. DAIRY PRODUCTS. Extension of remarks of Rep. Quie inserting an article criticizing USDA control program for dairy products. pp. A5623-4

BILLS INTRODUCED

31. IMPORTS. H. R. 12635 by Rep. Thompson, N. J., to amend section 311 of the Tariff Act of 1930 to permit the manufacture in bonded manufacturing warehouses of cigars made of tobacco imported from more than one foreign country; to Ways and Means Committee.
H. J. Res. 827 by Rep. Waggoner, requesting the President to enter into negotiations with Canada with respect to imports of softwood and authorizing the establishment of temporary import quotas for softwood; to Ways and Means Com.
32. TOBACCO. H. R. 12640, by Rep. Henderson; to amend the provisions of the Agricultural Adjustment Act of 1938 relating to tobacco to permit increased allotments to compensate producers of flue-cured tobacco for production losses sustained through natural disasters; to Agriculture Committee. Remarks of author p. A5623
33. RESERVOIRS. H. R. 12642 by Rep. Cooley, to authorize the Secretary of Agriculture to install a system of small and intermediate-size reservoirs in the Cape Fear River Basin, N. C.; to Agriculture Committee.
34. SURPLUS PROPERTY. H. R. 12643 by Rep. Curtis, Mo., to amend section 203(k) of the Federal Property and Administrative Services Act of 1949 to permit the transfer of surplus property for certain uses by educational institutions; to Government Operations Committee. Remarks of author p. 13427
35. VETERANS' BENEFITS. H. R. 12645, by Rep. Osmer, to amend title 38, United States Code, to provide vocational rehabilitation, education, and training, and loan guarantee benefits to persons who served in the Armed Forces on or after January 1, 1962, in combat zones; to Veterans' Affairs Committee.

nists are directing tremendous pressure to influence your thinking. The Communist Party of the United States is an integral arm of the International Communist movement. It is not a legitimate political party, but a conspiracy completely loyal to a foreign power, Russia.

The Communists in this country desire to overthrow our Government and establish a Soviet dictatorship. They scoff at the ideals of George Washington and Abraham Lincoln. To them, Thomas Jefferson was a misguided individual whose writings on liberty and freedom are archaic documents. If the Communists were in control today in America, we would be studying such Communist organizations as the Third International and such individuals as John Reed, one of the first Communists in America, and William Z. Foster, former chairman emeritus of the Communist Party, U.S.A., who died in Moscow. The whole history of our country would be written from a Communist point of view.

Why are the Communists today appealing so strongly to young people? Why are they encouraging high level party officials to speak to student groups? Why are they organizing Communist youth organizations? Why do they publish periodicals designed for youth?

The Communists realize that the young people will be the leaders of tomorrow. They want to influence their thinking now, to convince them that communism is superior to free government. Many of the top officials of the Communist Party of the United States became party members in their teens or their early twenties. Gus Hall, General Secretary of the Communist Party of the United States, was only 16 years of age when he became a party member. He is now the most powerful Communist in the United States.

When the young person is a teenager is the time he is forming his basic convictions in life—and the Communists know this. For that reason, they want to touch his thinking, to expose him to the deceitful double talk of their program. The Communists talk glibly of "peace," "justice" and "brotherhood." They claim that their system will bring a Utopia where struggle, pain and unhappiness will be abolished. These glittering promises are disproven by the harsh facts of reality. No nation has ever freely elected a Communist government. Millions of men, women and children have fled the Iron Curtain—risking their lives that they might reach freedom. The Communist world is a world of walls, searchlights and guards—a prison for the heart, mind and soul. Communist theory and practice have both been exposed as fraudulent.

The very intensity of this Communist effort to reach young people, however, shows how the enemy can be defeated.

One of our best defenses against communism is the strong moral character of our young people. They are the young men and women who know the real meaning of our American heritage. They know the trials and tribulations of our forefathers in bringing forth a nation conceived in liberty. They know that freedom is a precious commodity which must be won every day. They stand willing to do their share.

In this fight against communism, what are some of the qualities America expects from its young people? Let me mention a few:

1. High ideals: America was founded by men and women with high ideals, men and women whose daily lives were imbued with the vision of a great nation yet to come. Young people should have lofty ideals. They are the guideposts to the future.

2. Courage: This is the courage to get a job done, to persevere despite adversity. Too often there is the temptation to do a job halfway, to give up, to let others carry on. Such an attitude is wrong. We need young people who say, "Count on me all the way. I will do my job for America."

3. Self discipline: Young people must learn to discipline themselves, to make themselves useful to society. A mark of maturity is teaching ourselves the disciplines of hard work, loyalty, and dedication. Self-discipline is not an easy task. There are many storms and stresses along life's way. Self-discipline requires personal sacrifice and determination. But it is most essential.

4. Enthusiasm: Nothing injures a great cause more quickly than a "wet blanket." Be willing to volunteer to do a job, and do it enthusiastically. Enthusiasm is highly infectious. If you are enthusiastic for America, others will be also.

5. Integrity: To my mind, integrity is one of the most important words in our language. It sums up the quality of a man's character. Be honest in all of your dealings; be fair; be uncompromising in the pursuit of what is right. Stay loyal to your high ideals. Never sully them by dishonor, compromise or expediency.

Nikita Khrushchev, the world's No. 1 Communist, has characterized the United States as a "worn out runner running on its past reputation." Mr. Khrushchev views the United States as a dying nation, a country which will fall of its own weight.

Mr. Khrushchev, however, does not understand the citizens of this great Nation. He does not realize that they will take up the banner of freedom, that they will hold aloft the torch of freedom given them by their forefathers. You represent America's answer to this atheistic menace stemming from the perverted minds of Karl Marx and Friedrich Engels and voiced today by the blatant Khrushchev.

In this worldwide ideological struggle, how can you now best aid your country?

1. Seek to know more about the evils of communism, its strategy and tactics, its false claims. Nothing can take the place of responsible knowledge. For too long the Communists have thrived on our lack of knowledge about their affairs.

2. Take the time to learn more about the values which have made this Nation great. Do you know how our Constitution was written? What was the role of Benjamin Franklin and James Madison? What is the Bill of Rights? How did Thomas Jefferson contribute to American political thinking? These are questions about which you should be thinking.

3. Take every opportunity to visit the historic shrines of America. We in this Nation can be proud of the efforts made by the Government and private groups to commemorate historic events. When you travel, make the effort to see them. Each shrine has a story of America to tell—Bunker Hill, Independence Hall, Valley Forge. The visits of Americans, especially young people, to Washington, D.C., are an excellent way to know your country better. We appreciate very much your coming to see our FBI headquarters.

4. Contrast what communism has to offer with our way of life. Think of the blessings we have and count them one by one: freedom of speech, freedom of the press, the right to worship God as we wish, free elections, trial by jury. Do these rights exist under communism? The answer is "no." Communism means slavery of mind, body and soul.

5. Keep abreast of the news of the day, through your newspapers and on radio and television. What is occurring in your country, what are Communist nations doing? Ask yourself. Could you give a brief résumé today about the troubled areas of the world? America needs informed citizens.

6. Stand firm for your convictions. Today the Communists are trying to convince you that freedom is old-fashioned and that their way of life is superior. Know the strength of our institutions of Government. Be ready to defend them. Be able, if you were argu-

ing with a hard core Communist, to stand by your ground. That is the challenge.

Nothing will take the place of responsible knowledge in our fight against communism—a knowledge anchored in faith in God. We can defeat communism because we have the superior values, the superior way of life. The task will not be easy. But we can win if each of us is willing to do his share. We must meet communism with facts, not hysteria. Never must we be guilty of witch hunts or vigilantism. Truth is our best weapon of attack.

Not long ago I talked with a special agent of the FBI who was facing a very difficult problem. I can still remember the intensity of his eyes and the determination in his face. "I can meet this problem," he said, "because I am not going to give up."

Yes, we in America are not going to give up. We are going to win this battle—and in winning it, we are protecting liberty for all the generations yet to come.

THE IMPENDING MISSILE FACILITIES STRIKE

Mr. MUNDT. Mr. President, I should like to associate myself with the very forceful statements made yesterday by Senator McCLELLAN, Senator STENNIS, Senator CURTIS and others, expressing profound concern with the fact that work in our great missile and aerospace industry may come to a halt on Monday due to a nationwide strike. Six of our Nation's major defense contractors involved in the production and development of missiles and space vehicles are currently conducting last minute negotiations with the United Auto Workers and the International Association of Machinists in an effort to reach agreement on new contracts. The deadline date on these contract negotiations is just 3 days away on Monday, July 23, after which the UAW and the IAM have threatened to take their members out on strike if an agreement is not reached.

Mr. President, if this strike threat becomes a reality, and there are growing indications that it will, it has the potential to take 350,000 workers off the job and to bring our entire missile and aerospace production program to a standstill. It goes without saying that the economic and strategic consequences of such a national work stoppage would be catastrophic. Should such a strike eventuate the President has the present power under the Taft-Hartley Act to seek to enjoin this work stoppage for 80 days.

I trust that the President and his key legal advisers are already prepared to move under the Taft-Hartley emergency powers should the necessity for action arise. But, Mr. President, if a strike should occur and if a settlement is not reached during the 80-day "cooling-off period", neither the President nor any other officer or agency of the Federal Government will have the power to avert a strike in the most critical and strategic area of our national defense program. In my opinion this is an intolerable situation which demands forthright and prompt action by the Congress and the executive branch.

Mr. President, legislation has been before the Congress since September 23 of last year which is specifically designed to deal with circumstances just such as those which currently confront us. I

refer to S. 2631 a bill authored by Senator JOHN McCLELLAN and cosponsored by Senators ERVIN, CURTIS, HOLLAND, and myself. The provisions of this bill are limited in their application to labor-management relations in strategic defense facilities, which would include all of the missile and aerospace production companies involved in the present labor dispute with the United Auto Workers and the International Association of Machinists. Under the terms of the McClellan bill strikes in strategic defense facilities would be outlawed and where parties involved in contract negotiations in such a facility are unable to reach an agreement by the free and voluntary processes of collective bargaining the Secretary of Defense would be empowered to appoint an emergency arbitration board, representing the public and the parties to the dispute, which would be charged with the responsibility of working out a settlement agreement. Such an agreement would be binding on all parties for a period of 1 year, except to the extent modified by mutual consent or agreement of the parties.

This legislation was prepared after the extensive hearings on work stoppages and strikes at our missile sites and other defense facilities conducted by the Senate Permanent Investigations Subcommittee. It will be recalled by my colleagues that our investigation and hearings produced evidence that our manned space program was put 6 months behind schedule as a partial consequence of 327 work stoppages occurring over a 5-year period, which resulted in a total loss of 162,872 man-days of labor. Mr. President, the impending strike in our aerospace industry would immediately involve over 100,000 employees who are directly subject to the employment contracts in dispute. One has only to look to the damaging effects stemming from the loss of 162,872 man-days of labor to comprehend the extent and magnitude of the damage to our missile and space program which would flow from a national strike involving over 100,000 workers in its initial stage.

Mr. President, immediately following our investigations of the missile site work stoppages we were told by the President and the Secretary of Labor, Mr. Goldberg, that legislation was not needed to deal with this most distressing national problem. Instead the administration established a Missile Sites Labor Commission, composed of Government, labor, and management representatives, and empowered with the responsibility of trying to resolve voluntary settlements of the contract and jurisdictional disputes which give rise to these deplorable work stoppages in our defense program. We were told that such a program of voluntary mediation would solve the problem. I acknowledge that in the immediate aftermath of the establishment of the Missile Sites Labor Commission there occurred a sharp and encouraging reduction in work stoppages. However, beginning late last year and continuing through the early months of this year there has been a significant and disturbing increase in strikes and work stoppages at our missile sites.

While I do not want to deprecate the dedicated efforts of those serving on the Missile Sites Labor Commission, I am, nevertheless, becoming increasingly convinced that it was the congressional investigation and public exposure of these often senseless labor disputes which had the greatest impact in reducing the number of man-days of work lost rather than the voluntary mediation of the Commission. My convictions in this matter are based on the fact that the further away we have gotten from the public exposure of the hearings the more we have seen an outcropping of those elements and frictions which gave rise to the extensive work stoppages which resulted in slowing down our manned space program.

Now we see voluntary mediation and conciliation stymied in a series of contract disputes with two of the Nation's most powerful unions with the result that we could have a national strike which would make our past work-stoppage experiences look like the proverbial Sunday school picnic. Involved in these current disputes are such controversial but little-publicized issues as the union shop and supplemental unemployment benefits. It would be grimly ironic if those industries so critically involved in producing the weaponry with which American freedom is being protected were to be shut down by a strike arising out of the intransigent demands of the UAW and the IAM that employees desiring to work as skilled craftsmen in our aerospace industries be compelled to join one of these two powerful unions.

I earnestly hope that responsible individuals on both sides on these current labor disputes will recognize the critical and vital importance of avoiding a major work stoppage in our key defense industries. I hope also that those in Congress and the executive branch who have key roles in the area of labor-management relations will learn from our present dilemma and will hesitate no longer in coming to grips with the intolerable problem of a Government being powerless to protect its citizenry against the devastating threat to national security which would flow from a national work stoppage in our air defense production program. Mr. President, let us wait no longer; let us get on with consideration of the McClellan bill directed at strikes in strategic defense facilities.

ACTION BY FINANCE COMMITTEE ON REVENUE ACT OF 1962

Mr. BYRD of Virginia. Mr. President, I ask unanimous consent to have printed in the RECORD an announcement issued today of the action of the Finance Committee on the Revenue Act of 1962.

There being no objection, the announcement was ordered to be printed in the RECORD, as follows:

ANNOUNCEMENT OF THE SENATE FINANCE COMMITTEE, FRIDAY, JULY 20, 1962

The Senate Finance Committee today announced the following action after its executive session on the Revenue Act of 1962, H.R. 10650:

Entertainment expenses, etc., section 4: The Senate Finance Committee today agreed

to modify the definition of "gift" for purposes of the \$25 limitation in the following manner: (2) gifts designed to be used primarily on the business premises of the taxpayer, such as display racks and signs, are not to be subject to the \$25 limitation on gifts; (b) articles with a value of \$4 or less and with the name of the donor prominently and permanently imprinted thereon are not to be taken into account for the \$25 limitation; (c) gifts with a value of \$100 to an employee are not to be taken into account for purposes of the gift limitation if they are for length of service or for safety achievement.

In the case of meals and lodging expenses incurred in connection with traveling expenses, the committee modified the House bill to provide for the deduction of amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances.

The committee also agreed to provide for the allocation of traveling expenses where the journey involves both business and pleasure. Under this amendment, if the trip has a business purpose and is for less than 1 week, the entire amount would be deductible under the rules of existing law; if the journey is for a period longer than 1 week, the traveling expense is to be prorated between the business portion of the trip and the personal portion only if the personal portion of the period is more than 25 percent of the entire period.

The committee agreed to extend the exception of the House bill in the case of business meeting of employees or stockholders to also include business meetings of agents and directors and amended the provision further to make it clear that the expenses covered by the exception are those of the business with respect to meetings of its employees.

Effective date changed from June 30, 1962, to December 31, 1962.

Mutual savings banks, etc., section 8: The committee agreed to the bad debt reserve provisions of the House bill (i.e., deductions of 60 percent of taxable income, or deductions of amounts to bring the reserve up to 3 percent of qualifying real property loans, etc.) but amended the House bill to provide that privately owned (capital stock) building and loan associations are not to qualify for these bad debt reserves but are to be treated, taxwise, in the same manner as privately owned commercial banks.

It also provided that there are to be no additions to the reserve for losses on qualifying real property loans which bring the balance to more than 6 percent of such loans.

The committee also agreed to provide that deductions for additions to bad debt reserves shall in no event exceed the deduction which would have been allowed the institution had existing law continued to apply. Thus deductions would be limited to 12 percent of deposits.

The committee also adopted amendment 7-9-62-F, which provides that in allocating "pre-1963 reserves", reserves accumulated prior to 1952 are also to be taken into account in order to bring the balance of the reserve for losses on qualifying real property loans to 3 percent of such loans outstanding as of December 31, 1962. Under this amendment pre-1952 reserves are taken into account only for the purpose of measuring future deductible additions to the reserve for losses on qualifying real property loans but not for purposes of charging losses unless the institution so elects.

The committee also agreed to the provision of the House bill repealing the exemption from certain excise taxes but broadened the draft of the House bill to eliminate exemption from all excise taxes in

the case of federally chartered savings and loan associations.

Mutual Fire and Casualty Insurance Companies, section 10: The committee agreed to a technical amendment which permits certain flood insurance companies to be taxed in the same manner as perpetual fire insurance companies.

Earned income from sources outside the United States, section 12: The committee provided that the exclusion for bona fide residents is not to include a U.S. citizen who has made representations to a foreign government that he is not a resident of that country and therefore not subject to its income taxes.

It also made a technical amendment to amendment 7-9-62—G previously agreed to.

Ordinary income on certain gains from depreciable property, section 14: The committee agreed to the House provision.

Foreign investment companies, section 15: The committee agreed to a technical amendment which will permit foreign investment companies to reincorporate as a domestic investment company (in a tax-free reorganization) if the reincorporation occurs prior to January 1, 1964.

Tax treatment of cooperatives and patrons, section 17: The committee tentatively agreed to require that in order for a cooperative to receive a deduction for qualified script, at least 20 percent of the value of the patronage dividend (including qualified script) must be paid in cash. The staffs were instructed to review the consent provisions of the bill and report to the committee whether additional amendments should be made.

Distributions by foreign trusts, section 9: The committee amended the House bill so that amounts distributed by foreign trusts to U.S. beneficiary and taxed to him is to represent only that portion of the accumulated income which is attributable to property contributed to the foreign trust by U.S. persons.

The effective date of this provision was modified so that the new rules will apply to distributions made by foreign trusts after the date of enactment of this bill (rather than applying to distributions made in taxable years of trusts beginning after the date of enactment).

Inclusion of foreign real property in estate, section 18: The committee changed the effective date of this section from July 1, 1964, to January 1, 1963 (7-9-62—K).

Information with respect to foreign corporations, section 20: The committee adopted an amendment (7-9-62—L) liberalizing the rules with respect to giving of information as to foreign corporations.

Treaties, section 21: The committee adopted a new version of the section to read as follows: "No provision of this act shall apply in any case where its application would be contrary to any treaty obligation of the United States."

Foreign tax credit: The committee adopted a new amendment (7-13-62—F) providing for a special limitation on the foreign tax credit with respect to interest income earned in foreign countries. The effect of this amendment is to provide that the limitations on the foreign tax credit are to be separately computed as to interest income and as to income other than income.

CELEBREZZE RECOMMENDED

Mr. HARTKE. Mr. President, the Calumet Chapter of the American-Italian Societies has passed a resolution commending President Kennedy for his nomination of Cleveland, Ohio, Mayor Anthony J. Celebrezze, for the Cabinet position of Secretary of Health, Education, and Welfare.

Because of the nature of this resolution and because the members of this chapter of American-Italian Societies are, in the main, residents of northern Indiana, my home State, I think it worthwhile that it be called to the attention of all Members of the U.S. Senate, and I, therefore, seek unanimous consent to have it inserted in the body of the RECORD at this time.

There being no objection, the resolution was ordered to be printed in the RECORD, as follows:

Whereas there has never been an Italian-American appointed to the National Cabinet of the United States; and

Whereas President John F. Kennedy recently has nominated Cleveland Mayor Anthony J. Celebrezze as Secretary of Health, Education, and Welfare; and

Whereas five-time elected Mayor Celebrezze has done such an outstanding job in Cleveland that his confirmation by the U.S. Senate is now regarded as a certainty and imminent; and

Whereas this appointment will add to the great number of fine Italian-Americans already in public service, and will add greatly to the prestige of our colony in the United States; Now, therefore, be it

Resolved, That the Calumet Chapter, American-Italian Societies, hereby commend President Kennedy for this appointment of a man who will serve well all the people and will add a great deal to the already high caliber of the Cabinet; and be it further

Resolved, That copies of this resolution be sent to President John F. Kennedy, U.S. Senator Homer Capehart, U.S. Senator Vance Hartke, and the Honorable Anthony J. Celebrezze.

Submitted by Sam Bushemi, Lake County assessor, and cochairman, Calumet chapter, American-Italian Societies.

Attested to: Louis Ferrini, chairman, Calumet chapter, American-Italian Societies.

THE RESERVE CALL-UP

Mr. SYMINGTON. Mr. President, much has been said and written about the great contribution to our national security by the 145,000 reservists and National Guardsmen who were called to active duty a year ago.

One of the best summaries of the reasons for and benefits of the mobilization appeared in an editorial in the Kansas City Star on July 11, 1962.

Mr. President, I ask unanimous consent for insertion of that editorial at this point in the RECORD.

There being no objection, the editorial was ordered to be printed in the RECORD, as follows:

[From the Kansas City (Mo.) Star, July 11, 1962]

RESERVE CALL-UP GAVE THE UNITED STATES A WIDER CHOICE

American history will have a special niche for the 145,000 reservists and National Guardsmen who have started back to civilian life after serving nearly a year in the Berlin crisis military buildup. A single fact places these men in a class by themselves. Their call-up last fall marked the first time that a President had ever depended on trained citizen Reserves to support his foreign policy objectives.

The service of the reservists was extremely important in another way. It gave the understrength Active Forces the time and backlog to expand by more than 200,000 men. The Army has made the largest gain. It now has 90,000 more men and 16 combat-ready

divisions compared to a year ago. The United States today is in infinitely better shape to engage in a limited war if necessary.

What has happened is that this country has rounded out its military capabilities. Last July 25, President Kennedy explained: "We intend to have a wider choice than humiliation or all-out nuclear war." The buildup for a defense flexibility seems to have provided this wider choice.

FOUR PRESCRIPTIONS FOR OUR TIME

Mr. HUMPHREY. Mr. President, the July 1962 issue of the Journal of the American Pharmaceutical Association reprints an address which I was happy to deliver before the 109th annual meeting of one of the great professional organizations of our country, the American Pharmaceutical Association.

This meeting, in March 1962, was attended by the largest paid registration ever to attend an American Pharmaceutical Association convention. It was my privilege to address the largest audience of pharmacists ever to assemble under one roof in the United States.

The theme of my comments was "Four Prescriptions for Our Time"—that is, a prescription for peace, for prosperity, for freedom everywhere, and for the pharmaceutical profession, itself.

It is a pleasure to note that each issue of the journal of the association reflects the continuing interest of my fellow pharmacists in each and every one of these four challenges.

I ask unanimous consent that the prepared text of my address, as published in the current issue of the journal, be printed at this point in the RECORD.

There being no objection, the address was ordered to be printed in the RECORD, as follows:

FOUR PRESCRIPTIONS FOR OUR TIME (By Senator HUBERT H. HUMPHREY)

The four great prescriptions for our time are—a prescription for peace, for prosperity, for freedom everywhere, and for our own proud profession.

The pharmacist is more than just a professional man; he is a leader in his community. Leadership involves responsibility. We, ourselves, have the task, therefore, of helping to devise for our Nation the best possible formulas against war, against economic stagnation or depression, against the spread of communism throughout the globe and, here at home, against a variety of influences harmful to our profession.

As a nation, I believe, we are making significant progress toward all three of the initial objectives. And on the fourth goal, we, as a profession, under the American Pharmaceutical Association's leadership, are going to raise still higher our own standards rather than permit any source to undermine those standards.

PRESCRIPTION FOR PEACE

The formula for peace must be written against every possible contingency. Atomic war, conventional war, brush-fire war are all to be avoided—but through strength not weakness, resourcefulness not rigidity.

Berlin, Laos, Guantanamo—no one can predict the scene of tomorrow's possible conflagration. Of one thing we can be certain. Danger will always lurk somewhere. I would like to make one particular suggestion now. It is directed against a danger which is not sufficiently discussed—the danger of accidental war.

I mention this hazard because war by Soviet design seems infinitely less likely. And war by U.S. design is impossible.

I mention accidental war, too, because every pharmacist knows the meaning of precautions. Training against accidents is built into the very fiber of his work habits. But laymen tend to be less wary.

For the rest of our lives we will have to live with the chance of war by accident, by miscalculation, by uncontrolled escalation. The U.S. Government has taken every possible precaution against these hazards. We know that the North American Air Defense Command, the Strategic Air Command, and other defense arms have built elaborate safeguards into their systems.

I'd like to propose that the United Nations consider convening a conference on accidental war. The assembly could have an even broader representation than the present 18-nation conference on disarmament in Geneva, because accidental brush-fire war is always a possibility anywhere on the globe.

Much of the purpose of the Geneva discussion is to head off the danger of accidental war. But avoidance of war by miscalculation involves a whole set of specific political-military decisions and procedures which could be profitably studied in their own right, not merely as a part of arms reduction or a test ban.

We, in our open society, have little to lose from such a discussion. We have a world—and peace—to gain.

PRESCRIPTION FOR PROSPERITY

Let us meanwhile carry forward our effort for fullest prosperity here at home. That means assuring a satisfactory rate of economic growth, full employment, eliminating the pockets of distress in various areas of our country. It means girding ourselves to meet the growing competition from the Common Market. It requires, also, genuine tax reform.

PRESCRIPTION FOR FREEDOM IN EMERGING AREAS

On the world scene, let us advise the best medication for combating the virus of communism. Let us do so by providing the social and economic vitamins necessary to build strong, healthy nations, capable of resisting the contagions of Khrushchevism, Castroism, or Maoism.

As the American Pharmaceutical Association has well pointed out, pharmacy has an important role to play in this process. An American mortar and pestle means more to the billion people in the emerging areas than an American mortar or pistol. These billion people—in Asia, Africa, the Middle East, as well as Latin America—want the hope of health not the despair of sickness, the prospect of peace not constant reminder of war.

That is why we need to double and triple the role of what I call health for peace. I have been working with our profession toward this end in my capacity as chairman of a Senate international health study. Since August 1958, when we began our efforts, we have published 11 prints, 4 hearing exhibit volumes and a report. We have pointed out the critical shortage of pharmacists and of other skilled health professionals throughout the world. We have cited the significant activity of the World Health Organization in standardization of drugs.

In my personal view, a principal fault with the U.S. health programs abroad is a mistake no good physician or pharmacist would commit—the dosage is too small.

For example, in the last 4 fiscal years the Agency for International Development has brought over a grand total of only 29 foreign participants for professional pharmacy training for an average stay of about 12 months each. Fortunately, there are other federally sponsored international exchange programs. But this fact indicates

how inadequate the dosage is on the part of our foreign aid agency.

Last year, for a world plagued by sickness, a world to which the U.S. taxpayer contributed \$4 billion, AID bought a grand total of only \$1.2 billion in pharmaceuticals for direct health purposes. In addition, it bought and distributed \$29 million more in pharmaceuticals for what is called nonproject purposes; i.e., for resale by foreign governments for development purposes through domestic channels.

You will understand, then, why I want stronger doses of U.S. health aid. This includes—

More international exchange of personnel including undergraduate and postgraduate education of more foreign nationals at American colleges of pharmacy;

Expanded international cooperation in pharmacological and other research;

Expanded technical assistance through U.S. dollars and U.S.-owned or controlled soft currencies abroad, including distribution of more pharmaceuticals;

Encouragement of more nongovernmental action. This means fostering of more of the splendid people-to-people activities by the pharmaceutical profession and by the pharmaceutical industry.

In our next report, the subcommittee addresses itself to still another problem of particular interest to the American Pharmaceutical Association on the homefront. I refer to better communications between the healing arts professions, including physicians and pharmacists; between researcher and researcher; between researcher and medical practitioner; between the healing arts and the public.

PRESCRIPTION FOR OUR OWN PROFESSION

The American Pharmaceutical Association faces, in my judgment, the finest opportunities and some of the most stimulating challenges in its 109 years of history. What you decide on many important issues will reflect the ideas and feelings of pharmacists every where in the United States because the American Pharmaceutical Association, through its house of delegates, represents pharmacy. The American Pharmaceutical Association's committees, its labor in the scientific, legal, research, and communications fields, all contribute to a better, more satisfying profession for all of us.

As we are all aware, the American Pharmaceutical Association is called upon to testify in the Halls of Congress on many pharmaceutical matters. It is asked by State and local governments to assist in pharmaceutical service programs. Such requests are living praise of the significance of the American Pharmaceutical Association membership and of your work and devotion.

No citizen is more than a few minutes away from pharmaceutical services and help. That is why the civil defense authorities rightly make pharmacists a vital, integral part of emergency plans. The Public Health Service and Defense Department likewise count on pharmacists and are conducting manpower and location studies on our profession.

Being in daily, intimate contact with your fellow citizens and health associates, you appreciate and understand the changes that are taking place today. The pharmacist's role in the public health of the Nation is an ever-expanding one. Newer, more effective chemotherapeutic agents are being made available, new approaches to the mitigation and cure of disease are being developed.

An excellent example of planning for the future is the American Pharmaceutical Association Foundation's prepaid prescription service study. I understand that we are on the verge of pilot programs in several States. This is the kind of constructive programing that makes pharmacy a truly progressive

profession and demonstrates its concern with public welfare.

Now American Pharmaceutical Association is exploring better methods for pharmaceutical services in nursing homes. Nursing home personnel need and want such help. Our senior citizens can be profoundly served by your boards and associations working ever more actively with nursing home personnel.

As a pharmacist, a Senator and an American, I am proud of the thousands of daily practitioners of pharmacy who form the backbone of our medical care system. The pharmacist must, in my judgment, be enabled to continue to provide the highest degree of pharmaceutical service. That is why I stress in all legislation, touching on health care, that the patient have freedom of choice in selecting his pharmacist, physician and hospital.

I have sought at every opportunity to inform Congress, the Federal agencies and the public of the professionalism and self-discipline of pharmacy's practitioners. You and I know that when a person obtains prescribed medication he is not obtaining just a commodity—he is obtaining the services of a highly trained professional.

Each prescription order is as unique as the person for whom it is written. The very nature of the multitude of professional considerations involved renders each prescription a unique document. The medication is only dispensed by a pharmacist pursuant to a particular order of a particular prescriber. The medication is for a particular use in a particular quantity for a particular patient. It is for a particular condition, for a specific period of time and for use according to particular instructions.

A pharmacist does not sell a commodity—he is performing professional services in dispensing prescriptions. That is why he is so justified in seeking a professional fee for his services.

An indispensable element of professional service is the direct, personal relationship between the pharmacist, patient and prescriber. During my formative years in my dad's pharmacy, in Huron, S. Dak., I saw—unforgettably—the qualities of neighborliness and friendship between pharmacist, physician and patients.

This pharmacist-patient-prescriber relationship must be maintained. The pharmacist must be able to determine that the prescription document itself is valid, is for legitimate medical purposes and may be dispensed in good faith. If the slightest uncertainty exists, the pharmacist must be able to contact the prescriber personally. The physician, of course, carries the responsibility for proper prescribing but a corresponding liability rests with the pharmacist who dispenses the prescription.

Next, the pharmacist must be in a position personally to provide information about and determine whether the dosage and method of the medication's use—or the collateral measures necessary to the medication's use—are personally understood by the patient or a responsible member of his household.

Extremely important also is the fact that the prescription document is immediately available locally to the patient or prescriber.

The pharmacist must also be able to consult with prescriber and patient in instances where the individual may be undergoing treatment simultaneously by more than one prescriber and if the medications prescribed by each are incompatible.

But the key to an effective pharmacist-patient-prescriber relationship is the ability of the pharmacist to dispense immediately any medication which any pharmacy can be reasonably expected to provide.

It is for these reasons that objection is rightly made to a phantom pharmacist who never has personal contact with the patient or to those occasional pharmacists who use

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secondary use for public recreation. p. D658

16. WILDLIFE; SURPLUS PROPERTY. The Commerce Committee voted to report with amendment (but did not actually report) S. 2358, to authorize the transfer of surplus real property to the Department of the Interior or to the States for use in wildlife conservation programs. p. D658
17. COMMUNICATIONS. Continued debate on the motion by Sen. Mansfield to consider H. R. 11040, to provide for the establishment of a commercial communications satellite system. pp. 14128-87
18. COMMITTEE ASSIGNMENTS. Sen. Dirksen was appointed a member of the Joint Committee on Atomic Energy. p. 14154
19. TAXATION. The Finance Committee voted to report with amendments (but did not actually report) H. R. 10650, the proposed Revenue Act of 1962. p. D658

ITEMS IN APPENDIX

20. DAIRY INDUSTRY. Extension of remarks of Rep. Westland discussing the importance of the dairy industry to the State of Wash. p. A5859
21. FOREIGN AID. Extension of remarks of Rep. Alger inserting an article, "It's Only Round 1," which suggests that the people will have the final say on foreign aid appropriations. p. A5868
22. FORESTS. Extension of remarks of Rep. Hansen expressing her support for the President's announced intention to seek an additional \$10 million for Forest Service roads and trails in an effort to increase the amount of Federal timber available for the Nation's lumber industry. pp. A5876-7

BILLS INTRODUCED

23. RECREATION. H. R. 12731, by Rep. Slack, to provide for the establishment of the Coal River National Recreation Demonstration Area, in the State of West Virginia to Interior and Insular Affairs Committee.
24. RURAL AREAS. H. R. 12733, by Rep. Johnson, Md., to establish a Rural Renewal Commission; to Agriculture Committee.

BILL APPROVED BY THE PRESIDENT

25. TEMPORARY APPROPRIATIONS. H. J. Res. 839, the appropriations continuation resolution to make temporary appropriations until August 31, 1962, to those departments and agencies, including this Department, whose annual appropriation bills have not yet been enacted. Approved July 31, 1962 (Public Law 87-564).

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COMMITTEE HEARINGS AUG. 1:

Foreign trade bill, S. Finance.

S. Agriculture and Forestry (exec).

H. Agriculture Subcommittee on Family Farms (exec).

Reclamation bills, S. Interior (Young and Steele, SCS, to answer questions).

Status of the economy, H. Ways and Means (exec) (Farm Bureau to testify).

Extra pay for hazardous positions, H. Civil Service (Macy, CSC, to testify).

agency (pp. 15662-5). By a vote of 64 to 11, tabled an amendment by Sen. Kefauver to provide that the Federal Government would own the satellite system and would "establish an AEC type of direction for space satellite communications" (pp. 15673-8).

18. TAXATION. The Finance Committee reported with amendments H. R. 10650, the proposed Revenue Act of 1962 (S. Rept. 1881). p. 15683
19. ELECTRIFICATION. Sen. Mundt contended that there was no need for enactment of S. 3153, granting the Pacific Northwest first call on power generated at Federal plants in that region and expressed hope the House would not pass it. pp. 15687-8
20. EXTENSION WORK. Sen. Wiley inserted a letter from the director of the extension division of the Univ. of Wisconsin supporting enactment of legislation to improve and strengthen the extension program. p. 15688
21. WATERSHEDS. The plans for works of watershed improvement, recently submitted to Congress by the Budget Bureau, included Duncan Creek, S.C., and Neshobe River, Vt. These were omitted from the list in the Congressional Record. (See Digest 143, item 3.)

ITEMS IN APPENDIX

22. EDUCATION. Extension of remarks of Sen. Wiley inserting a copy of a letter to Rep. Cooley urging a strengthening of vocational and educational training programs. p. A6241
23. BUDGETING. Extension of remarks of Rep. Ryan inserting an article, "Cutting Taxes and Balancing Budgets," analyzing out budgeting methods and the budgeting practices of Western European countries. pp. A6251-2
24. FOREIGN TRADE. Extension of remarks of Rep. Green inserting an address by Under Secretary of Commerce Gudeman, "Trade: Our Problem Is One of Increasing Growth, Both Domestic and Export." pp. A6255-6
25. FOREST LANDS. Extension of remarks of Rep. Johnson, Calif., inserting an article, "Multiple Use as Concept of Land Management." pp A6261-3
26. TEXTILES. Extension of remarks of Rep. Dent inserting a letter from the Carded Yarn Association on problems "being inflicted because of trade policies." pp. A6264-5
27. FARM PROGRAM. Extension of remarks of Rep. Weaver inserting an editorial, "This Farm Proposal a 'Gasser'", criticizing the CED report on agriculture. p. A6265
28. PRICES; LABELING. Extension of remarks of Rep. MacGregor urging passage of the quality stabilization bill. pp. A6267-8
29. FARM LABOR. Extension of remarks of Rep. Roosevelt urging passage by the House of bills already passed by the Senate to aid migratory farm workers. p. A6270
30. PUBLIC WORKS. Extension of remarks of Rep. Blatnik urging passage of the public works acceleration bill and inserting an explanation of the bill in question-and-answer form. pp. A6282-3

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6. RESEARCH. The Rules Committee reported a resolution for the consideration of H. R. 12712, to assist the States to provide additional facilities for research at the State agricultural experiment stations. p. 15760
7. WHEAT. The Banking and Currency Committee reported without amendment S. 3574, to extend the International Wheat Agreement Act of 1949 so as to implement the 1962 International Wheat Agreement (H. Rept. 2246). p. 15760
8. TAXATION. The Ways and Means Committee reported with amendment H. R. 5260, to repeal the 3 cents per pound processing tax on coconut oil (H. Rept. 2239). p. 15760
9. ADMINISTRATIVE PROVISIONS. The Subcommittee on Departmental Oversight and Consumer Relations of the Agriculture Committee voted to report to the full committee with amendments H. R. 12811, to facilitate the work of the Department of Agriculture. p. D738
10. TERRITORIES. The Subcommittee on Departmental Oversight and Consumer Relations of the Agriculture Committee voted to report to the full committee with amendment S. 2121, to provide Federal agricultural services to Guam. p. D738
11. ROADS. Rep. Fallon criticized the freezing of Federal-aid highway funds saying, "This freezing of funds, known officially as reimbursement scheduling, has held back the highway program in a number of States." p. 15759
12. MINING. Rep. Saylor discussed his bill H. R. 12913, to modernize the mining laws of the U. S. pp. 15746-7
13. LEGISLATIVE PROGRAM. Rep. Albert announced that the Consent Calendar and the Private Calendar will be called on Mon., and that the House will adjourn from Mon., Aug. 20 to Thurs., Aug. 23, and from Thurs., Aug. 23, to Mon., Aug. 27. p. 15757
14. ADJOURNED until Mon., Aug. 20. p. 15760

SENATE

15. FARM PROGRAM. Sen. Mansfield announced that the farm bill will be considered after disposition of the communications satellite bill (pp. 15665, 15679). Sen. Keating expressed opposition to taking up the farm bill and stated that he would "use the balance of my time on the pending satellite bill...so as to defer action on the farm bill" (pp. 15679, 15680).
Sen. McCarthy submitted an amendment intended to be proposed to the farm bill "to add a dairy program to the new version of the Senate farm bill." He stated that his proposed amendment "incorporates the House provision in general." pp. 15684-6
16. FARM LABOR. Sen. Williams, N.J., inserted and commended a letter he received from the executive vice-president of the Council of California Growers stating that the Council "is not planning any...legal action against Secretary of Labor Goldberg, nor does the council intend to bring any such legal action against Secretary Goldberg in the future" in connection with the setting of minimum wages for Mexican farm laborers. pp. 15689-90
17. COMMUNICATIONS. Continued debate on H. R. 11040, the communications satellite bill (pp. 15630-66, 15669-80). By a vote of 68 to 15, tabled an amendment by Sen. Yarborough to require the President to take all necessary steps to insure the availability of the communications satellite system for use by any Federal

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